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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 705

COMPETITION IN THE RAILROAD INDUSTRY

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SUPPLEMENTAL COMMENTS OF NORFOLK SOUTHERN RAILWAY COMPANY

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Norfolk Southern Railway Company ("NS") submits these Supplemental Comments to respond to questions and issues raised at the Surface Transportation Board's ("STB") hearing on Ex Parte 705. *See* Decision, STB Ex Parte No. 705, *Competition in the Railroad Industry* (served June 30, 2011). NS joins in the Supplemental Comments of the Association of American Railroads ("AAR"), and offers the following Supplemental Comments in response to several matters raised at the hearing.

INTRODUCTION

Parties who advocated for increased regulatory intervention in this proceeding failed to make their case. Tellingly, when a Board Member observed that shippers advocating forced access had been making the same arguments for years, and asked them what had changed to justify Board action, their best answer was that shippers were "now on the same page."[1] Even this half-hearted rationale is demonstrably false. In fact, numerous rail customers from many sectors of the economy submitted comments and testimony urging the Board not to make such regulatory changes.[2] The minority of shippers who importune the Board to change longstanding rules and regulations and engage in new, disruptive market interventions rely primarily on anecdotes and unsupported claims and conjecture. In contrast, rail carriers have responded with actual evidence showing the claims of this narrow segment of shippers are incorrect and do not remotely support the regulatory "fixes" they advocate.

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[1] *See* Testimony of witness Michael McBride on behalf of the Interested Parties (File 1, 01:03:01).

[2] As NS described in its Reply Comments, numerous shippers have urged to Board *not* to impose new access and routing regulations, because they believe "regulatory changes would adversely affect the rail transportation service they receive." *See* NS Reply Comments at 22, n. 17; *See*, discussion of Consol Energy, Inc. ("CONSOL") at Part II.B *infra*.

At the hearing, proponents of increased regulatory intervention proffered five rationales for imposing forced access and forced interchange: (i) improving railroad financial health; (ii) railroads' alleged failure to compete; (iii) railroads' alleged discrimination against exports; (iv) harm to the U.S. chemical industry purportedly caused by railroads; and (v) railroads provide only "take-it-or-leave-it" offers. In "support" of those claims, witnesses largely relied on anecdotes and unsubstantiated allegations rather than facts or evidence. The railroads, on the other hand, provided actual facts and evidence that rebut each rationale.

Moreover, forced access proponents failed to acknowledge the results and benefits of the current regulatory system and policies that Congress and the Board have implemented to address the interests of all rail industry stakeholders in a balanced manner. Parties advocating forced access also generally ignored the Board's directive to address the impacts of any forced access proposal, which NS and other rail carriers demonstrated would cause harm in terms of network operational effects and rail system investment.

Below, NS addresses the key questions and themes raised at the hearing regarding the foregoing issues and responds to testimony and questions about legal constraints on the Board's power to change access and routing rules, and regulations without congressional action to change the law.

I. ADVOCATES OF INCREASED REGULATORY INTERVENTION RELY ON ANECDOTES AND UNSUBSTANTIATED ALLEGATIONS RATHER THAN FACTS AND DATA.

Vice Chairwoman Begeman asked parties what has changed that would justify the Board taking action given that some of those seeking forced access and forced interchange have had the same complaints for years. Instead of providing actual analysis or concrete evidence in support of their claims, witnesses advocating forced access or forced interchange simply offered undocumented anecdotes and unsupported allegations.[3] The themes of forced access proponents' testimony fall into four general and unsubstantiated rationales for the new regulatory intervention they propose. As NS explains below, those parties' conclusory claims and rationales do not withstand scrutiny. On the contrary, available evidence shows them to be baseless and wholly inadequate to support the reversal of sound existing law and policy.

A. Improving Railroad Financial Health Does Not Justify Forced Access.

First, advocates of increased regulatory intervention argued at the hearing that the recently improving financial health of railroads justifies a significant regulatory change. Largely relying on a single partisan Senate Committee staff report[4] and a Fortune Magazine listing,[5] some witnesses asserted that railroads should be declared revenue adequate, and effectively called for the repeal of pillars of the Staggers Act and imposition of forced access, interchange and routing regulation.[6] Left unexamined in these calls for re-regulation are the deleterious long

[3] Commissioner Mulvey recognized this general problem, stating: "One of the things that sort of bothered me a little bit about all of the testimonies I received...that there's shortage of analysis in these and I would like to get more analytical input to help the Board make decisions..." (File 1, 1:10:05). The Board cannot make sweeping policy changes without such detailed analysis.

[4] STAFF OF S. COMM. ON COMMERCE, SCIENCE, & TRANSP., 111TH CONG., REP. ON THE CURRENT STATE OF THE CLASS I FREIGHT RAIL INDUS. (COMM. PRINT 2010).

[5] Fortune 500, Top Industries: Most Profitable, *available at* http://money.cnn.com/magazines/fortune/fortune500/2009/performers/industries/profits/.

[6] *See e.g.*, Testimony of Glenn English, Consumers United for Rail Equity ("CURE") ("We spent 20 years dealing with the health - financial health of the railroads. We spent 20 years trying to put the railroads in shape so they would be able to deliver not only for our members but for America and I think without question they're in that shape. The promise was made during that twenty year period that once the railroads were on their feet...we would receive fair treatment.") (File 2, 05:10:00). Mr. English's view of the Staggers Act suggests that the law's competitive reforms were designed as short-term measures to be reversed once the railroads financial health began to improve. This is revisionist history – nothing in the legislative record states that, if rail carrier health improved, new, more shipper-favorable rail regulation would be imposed. As nearly every analysis has found, both shippers and railroads benefited greatly from Staggers Act reforms and resulting rationalization, reductions in rail rates, service improvements, and improved financial stability of rail carriers. The resounding success of the Staggers Act and subsequent reforms is hardly a reason to repeal those reforms.

term effects on the rail transportation system of dragging rail carriers and their customers back to the disastrous policies and regulatory mind-set of the pre-Staggers era.

It is not only the railroads who doubt the wisdom of forced access and forced interchange proposals. At the hearing, two independent financial analysts specializing in freight transportation industries testified: Tom Wadewitz, a Transportation Equities Analyst with J.P. Morgan Chase & Co. and Scott Group, a Senior Transportation Analyst at Wolfe Trahan & Co., a research firm specializing in freight transportation. The perspectives of Mr. Wadewitz and Mr. Group are particularly important because they represent informed and objective third parties who stand outside of the shipper/carrier relationships. Their job is to analyze the freight railroad industry and make independent and objective recommendations to private investors as to whether or to what extent they should invest in the railroads. Without the private investment that analysts like Mr. Wadewitz and Mr. Group facilitate, railroads would be unable to make the high capital expenditures that are required to maintain and improve the rail network.[7] The result of significant reductions in rail capital expenditures would be disastrous for railroads and shippers alike. As Mr. Group explained, "railroad capex is historically very dependent on the health of the industry...over the past five and ten years, railroads have spent an average of 16.6 and 16.4 percent of their total revenue on capital spending. This is three times higher than the roughly

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[7] NS and other carriers have explained the importance of capital investment to the maintenance and expansion of service and capacity on numerous occasions, including STB Ex Parte No. 664. NS includes as an exhibit to these comments, and incorporates by reference to this filing, testimony it submitted in that proceeding. *See* Written Testimony of Norfolk Southern Corporation, STB Ex Parte 664, *Methodology to Be Employed in Determining the Railroad Industry's Cost of Capital* (Nov. 27, 2007) (copy attached as Exhibit A hereto).

5.5%, on average, of the Dow Jones industrials."[8] Both financial analyst witnesses testified as to the necessarily long term nature of railroad finances.

The reports relied on by the proponents of forced access and forced interchange for their conclusions about railroad financial health are deeply flawed and incomplete. Regarding the Senate Commerce Committee Report, Commissioner Mulvey noted its manifest shortcomings during the hearing when he asked a shipper panel for analytical studies demonstrating railroad profitability. When the Senate Commerce Committee Report was offered in response, Commissioner Mulvey reemphasized he was looking for "objective, analytical studies" and not the Committee Report.[9] Tom Wadewitz of J.P. Morgan also testified as to the shortcomings of the limited and superficial Fortune list. Mr. Wadewitz indicated that focusing narrowly on "margins as a measure of profitability" and railroad industry financial health makes it appear that rail carriers are financially strong.[10] But, he explained that it was important to look beyond margins and earnings to get a meaningful and accurate picture of rail carrier finances. As Wadewitz further explained, "the other side of the equation you can't forget about...the capital intensity and investment base...while [railroads] may look attractive from an absolute margin perspective, if you look at financial returns and the amount of capex they spend or the capital intensity as a percent of revenue, then those two together give you the result that returns are not that strong..."[11] Mr. Wadewitz's point is that, moving beyond the superficial headlines and into

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[8] Testimony of Scott Group, Wolfe Trahan & Co. (File 2, 02:28:44); *See also*, n. 12, *infra*. The capital needs of railroads was well documented in the Initial Comments and Reply Comments, *see, e.g.*, Initial Comments of Canadian Pacific Railway Company at 33-35.

[9] Question of Commissioner Mulvey (File 1, 01:10:05).

[10] Testimony of Tom Wadewitz, J.P. Morgan (File 2, 02:35:00).

[11] *Id.*, at 02:35:20.

the full story, the real picture of railroad finances is both more complex and substantially different than can be conveyed through simplistic, isolated data points and lists.

Forced access proponents also fail to address the direct relationship between strong investment returns and carriers' ability to invest in their systems, assets, and to make other capital expenditures necessary to maintain and improve rail transportation service. As explained by Union Pacific Railroad Co. ("UP") CEO Jim Young, "if regulation prevents [railroads] from generating competitive returns on the replacement value of our capital investments, [railroad] shareholders will not allow [railroads] to continue investing at the levels [railroads] have planned."[12] Mr. Young went on to explain that rail carriers' stock buybacks and dividend payments, attacked by advocates of greater regulatory intervention, attract investors, who provide the capital necessary to maintain and improve their rail systems.[13]

At the hearing and throughout the Ex Parte 705 proceeding, forced access proponents have flatly asserted that NS and other railroads are "revenue adequate."[14] Freight railroad investment analyst Scott Group strongly disagreed, however, testifying that "return calculations are based on the rail's historic book value, values which are materially understated...the asset base of the rails would increase roughly three times on a replacement basis."[15] Moreover, across

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[12] Testimony of Jim Young, UP (File 1, 04:47:10); *See also*, FN 8 *supra*.

[13] *Id.*, at 04:47:47 ("Every company must balance between providing investors with immediate returns in the form of stock buybacks and dividend payments and investing capital for long term value appreciation. We can't ignore shareholder demands that we allocate some of our cash to stock repurchases and dividends...We must compete for capital with other companies that provide the same type of returns to their investors.").

[14] *See, e.g.*, Initial Comments of Westlake Corporation at 16-30. ("There is no question that the Class I railroad industry as a whole is quite healthy, and has been 'revenue-adequate' for some time...Norfolk Southern...has been 'revenue-adequate'...for most of the last several years."). The Board's notice commencing this competition proceeding did not include the Board's annual revenue adequacy analysis within the scope of the proceeding. Therefore, NS responds only briefly to other parties' assertions regarding this issue.

[15] Testimony of Scott Group, Wolfe Trahan & Co. (File 2, 02:30:52).

the industry, "average rail returns have only exceeded the industry's cost of capital once in the fourteen year period...[and]...none of the rail[roads] earned their cost of capital in 2009."[16] According to Mr. Group, "the rail industry is not yet revenue adequate on a *long term basis*."[17]

Mr. Group's focus on the "long term" is important. Forced access proponents have a habit of pointing to specific years or a short series of years to argue that the railroads are revenue adequate. As the Board has repeatedly emphasized, however, revenue adequacy is a complex, long run concept and it cannot be determined by short term measures, such as annual comparisons of cost of capital to return on investment.[18] Certainly railroads are in better health today than three decades ago, thanks in large part to the regulatory reforms initiated by the Staggers Act. That improved health is a positive development and was a central goal of the landmark 1980 legislation.[19] However, improving financial health does not justify the type of radical regulatory change proposed here.

B. The Evidence Does Not Support The Forced Access Proponenes Allegations That Rail Carriers Fail To Compete.

As NS and other carriers demonstrated in their Comments, rail-to-rail competition today is vigorous and extensive. When competition with other modes and modal combinations is considered, there is little doubt that competition for the surface transportation market in the United States is as strong and robust as it has ever been. Several forced access and forced

[16] Testimony of Scott Group, Wolfe Trahan & Co. (File 2, 02:30:35).

[17] *Id.*, at (File 2, 02:31:13) (emphasis added).

[18] At the hearing, one Board Member reiterated the Board is looking for long-term analysis and not analysis "just for a single year." (File 1, 01:10:45).

[19] Opening Comments of CSX Transportation, Inc. at 17 ("Improving the financial health of the rail industry was a key goal of the Staggers Act") (citing the statute and a GAO Report); Testimony of George Macko, United States Gypsum Company ("USG") ("It is USG's position that this [rail] renaissance was the intended objective of the Staggers Act.") (File 3, 04:15:55).

interchange proponents argue, however, that railroads do not provide the rates customers want even when there are two or more railroads serving them.[20] Setting aside for the moment that such allegations call into question the entire premise of using forced access to "increase competition," as the proponents argue, these conclusory statements were only anecdotal and not supported by real evidence.

Evidence provided by western carriers refuted these claims with actual data, demonstrating the shifts in Powder River Basin coal transportation business between the two railroads between 2004 and 2011. Coal delivery to eleven power plants changed multiple times during those years.[21] And such direct rail-to-rail analysis does not even consider multi-modal competition.

Competition between eastern rail carriers has resulted in similar turnover of business and customers. NS has included an exhibit – prepared by the AAR based upon data submitted by carriers – that shows traffic volumes and market share changes for CSX and NS for agricultural products, coal, and all traffic over the last decade. *See* Exhibit B. As the exhibit shows, rail freight traffic shifts between carriers substantially, not just on an annual basis, but every quarter.[22] The exhibit further illustrates that competition for rail freight transportation in the East

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[20] *See, e.g.*, Testimony of Peter Pfohl, Western Coal Traffic League ("WCTL") (Raising concerns with "near tripling of Powder River Basin rates between 2003 and 2010" for shippers with more than one railroad) (File 2, 00:10:15); Testimony of C. Michael Loftus, Concerned Captive Coal Shippers ("What you have heard…is competitive shippers who…would prefer to be treated like captive shippers in the context of competition that isn't in fact functioning.") (File 2, 00:50:51).

[21] BNSF Ry. Co. ("BNSF") Hearing Exhibits at 7.

[22] The exhibit understates the actual proportionate changes in competitive traffic, because the data includes traffic to or from solely served facilities.

is strong and effective.[23] Rail shippers, such as Christopher Marsh of CONSOL, testified to the vigor and effectiveness of rail competition in the eastern United States. According to CONSOL, the largest eastern coal company, NS and CSXT are "creative, *competitive*, and cooperative."[24]

In sum, the evidence demonstrates that NS competes fiercely for business both with other rail carriers and with other modes of transportation.[25] There is no evidence in the record suggesting otherwise, and a few shippers' unsupported speculation provides no basis for forced access or other proposals for regulatory change in the name of increasing competition.

C. Unsupported Claims That Rail Carriers Harm Exports Do Not Withstand Scrutiny.

Several forced access proponents made unsupported allegations that U.S. rail carriers discriminate against exports in favor of imports.[26] That claim is baseless and implausible. Railroads have no reason or incentive to favor imported freight over freight bound for export. Further, the evidence in the record demonstrates that U.S. exports have been growing steadily

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[23] Even if the evidence did not show such competition and change in market share, AAR witness Dr. Robert Willig explained that a lack of traffic turnover between carriers did not necessarily signal a lack of competition "because it makes sense that after a while when competition has worked itself out, the market will find efficient match-ups between the abilities of a transportation carrier and the needs of a customer, and even if the traffic jumps back and forth for a while it's likely to settle down into its most efficient set of logistics as long as the basic circumstances aren't changing radically from year to year." Testimony of Dr. Robert Willig (File 1, 02:46:15).

[24] Testimony of Christopher Marsh, Consol Energy (File 3, 01:02:33) (emphasis added).

[25] A rail carrier's decision regarding whether and how to bid on a particular piece of competitive business is complex and involves many factors and considerations. In some instances, other business considerations may prevent a rail carrier from making an effective bid. A railroad could also choose to bid for a competing shipper's business instead because it might provide a greater rate of return. Alternatively, operational or capacity constraints on particular routes may counsel against bidding on traffic that could cause capacity problems or service disruptions. Thus, the fact that not all shippers or traffic moves back and forth between competing carriers every year at every contract expiration by no means indicates a lack of competition.

[26] *See, e.g.*, Testimony of Scott Stone, Interested Parties ("If you look at...the leading export industrial sectors in the United States...this is the freight that bears some of the highest rates...The freight that tends to bare the lowest rates are the manufactured products from abroad...) (File 1, 01:17:30); Testimony of Michael McBride, Interested Parties ("First let me mention what may be the most important point, which is the impact that railroads' rates and practices are having on the ability of railroad customers in this country to produce products that compete with imports.") (File 1, 00:33:30).

since 1992 and that they hit an all-time monthly high in March of 2011.[27] This is hardly the result that would be expected if rail carriers were undermining U.S. exports.

More specifically, NS traffic data belies the reckless and unfounded notion that NS is discriminating against export traffic. In both 2008 and 2009, NS moved approximately twice as many export carloads as imports.[28] Actual data disproves the unsupported speculation and irresponsible allegations of a minority of shippers seeking the Board's assistance to artificially reduce their rail rates.

D. Allegations That Railroads Are Undermining the U.S. Chemical Industry Are Undermined By Fact and Evidence.

At the hearing, some chemical shippers alleged that rail rates are harming the chemical industry in the United States, causing plant shutdowns, job losses and other harm.[29] As with the claim that railroads are favoring importers over exporters, these shippers have been unable to articulate any motive railroads would have to undermine their own customers. As Senator Rockefeller and the AAR agreed, the relationship between shippers and railroads is symbiotic.[30] Without the chemical industry and other shippers, railroads would have no freight to move. Chemical shippers in particular are among rail carriers' largest and most important customers.

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[27] *See*, NS Oral Argument Exhibits at 15 (Citing U.S. Bureau of Economic Analysis).

[28] *See, e.g.*, NS Oral Argument Exhibits at 16. Even if coal is excluded, NS's volume of export traffic exceeded import traffic volume by more than 25 percent in both years.

[29] *See, e.g.*, Testimony of Robin Burns, Occidental Chemical Corporation ("Recently we shut down several OxyChem plants. These decisions were partly due to our rapidly escalating rail freight rates.") (File 3, 02:01:25).

[30] Testimony of Senator John Rockefeller ("It all has to kind of work together for it to work for anyone. It's really a symbiotic relationship. The nation's manufacturing sector needs the railroads. And the railroads would be out of business without their shippers.") (File 1, 02:03:25); Testimony of Edward Hamberger, AAR ("I agree very strongly with something Chairman Rockefeller said this morning. He indicated that there is a 'symbiotic,' his word, 'symbiotic relationship' between railroads and their customers. And that is incredibly accurate...we're out of business without their business.") (File 1, 03:10:00).

In their testimony before the STB, some chemical shippers suggest that rail rates are major, critical costs of their products, and that increased rail rates are a major risk to their business. But in different settings, chemical companies sing a different tune. Securities and Exchange Commission Form 10-K requires publicly traded companies to list risk factors in Item 1A of the report. The purpose of this 10-K item, among other things, is to disclose to the market significant risks of investing in the company. The 10-Ks filed by five publicly traded chemical companies that testified at the Board hearing indicate that rail rates are not a predominant risk to these companies' economic health. In their disclosures of significant risks, Dow Chemical Corporation ("Dow"), E.I. du Pont de Nemours and Company ("DuPont"), Occidental Chemical Corporation, and PPG Industries ("PPG") all fail to even *mention* the threat of rising freight rail rates among the risk factors they face.[31] Only Olin Corporation ("Olin Corp.") even mentions transportation costs as a risk factor. And even Olin mentions transportation costs simply as one component of the overall risk of rising costs across a variety of areas, including raw materials.[32]

Dow, DuPont, and PPG also discuss the cost of raw materials, specifically natural gas, as a major risk factor. That is not surprising given the chemical industry's public statements on the effect of high natural gas costs on their businesses. The American Chemistry Council testified

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[31] Dow Chemical Corporation, 2010 Annual Report (Form 10-K) (Feb. 10, 2011) at 18-20, *available at* http://www.sec.gov/Archives/edgar/data/29915/000119312511040023/d10k.htm#tx102245_3; E.I. du Pont de Nemours and Company 2010 Annual Report (Form 10-K) (Feb. 8, 2011) at 6-9, *available at* http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9NDEzMDc1fENoaWxkSUQ9NDI0MTU3fFR5cGU9MQ==&t=1;Occidental Petroleum Corporation 2010 Annual Report (Form 10-K) (Feb. 24, 2011) at 6-7, *available at* http://services.corporate-ir.net/SEC.Enhanced/SecCapsule.aspx?c=76816&fid=7400811; PPG Industries, Inc. 2010 Annual Report (Form 10-K) (Feb. 17, 2011) at 10-12 *available at* http://www.ppg.com/corporate/investorcenter/sec/Documents/2010AnnualReport.pdf. Several of the companies do discuss the potential risk of transporting hazardous chemicals, something NS carriers out each day for many of these companies.

[32] Olin Corporation 2010 Annual Report (Form 10-K) (Feb. 24, 2011) at 13, *available at* http://www.b2i.us/profiles/investor/ViewSEC.asp?dHlwZT1wJmI9JklEPTc3NDgwNDM=.

before Congress in 2005 that "[h]igher [n]atural [g]as[p]rices[s]hift [c]hemical [i]ndustry [i]nvestment [o]verseas."[33] Indeed, as natural gas prices rose in the middle of the decade, U.S. chemical companies closed domestic facilities and shifted investment and production to other countries.[34] Those shifts in production, jobs, and investment were driven by natural gas prices, and not rail rates. And, decreases in production and shipments from domestic chemical facilities also represent lost business for rail carriers serving those facilities.

Today, domestic chemical manufacturers are *expanding* production in the U.S. and North America. As the industry widely announced, the current "low price for natural gas...has enabled U.S. chemicals manufacturers to become more competitive than producers in much of the rest of the world."[35] A driving force for these lower prices is the discovery of abundant domestic shale gas reserves and the development of processes to extract them economically, creating a new set of conditions that the American Chemistry Council has proclaimed a "'game changer' for America's chemical manufacturers."[36] As a result, chemical manufacturing in the United States is experiencing a resurgence, not the decline that a few industry witnesses at the hearing would

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[33] NS Oral Argument Exhibits at 17; *The Impacts of High Energy Costs to the American Consumer: Oversight Hearing Before the Mineral Resources Subcomm. of the H. Comm. on Resources*, 109th Cong. 109-13 (2005) (testimony of the American Chemistry Council) (May 19, 2005) at 61, *available at* http://www.gpo.gov/fdsys/pkg/CHRG-109hhrg21446/pdf/CHRG-109hhrg21446.pdf.

[34] Reply Comments of NS at 36.

[35] NS Oral Argument Exhibits at 18; Press Release, American Chemistry Council Economic Outlook for U.S. Chemistry Industry Improving, ACC's Year-End Report Reveals (Dec. 3, 2010), *available at* http://www.prnewswire.com/news-releases/economic-outlook-for-us-chemistry-industry-improving-accs-year-end-report-reveals-111264279.html.

[36] Id.

have the Board believe.[37] After the Board's hearing, the president and CEO of the American Chemical Council published an opinion article, stating in part:

> Natural gas is the primary raw material, or feedstock, used by the chemical industry to create ingredients for 96 percent of all manufactured goods. To put it simply, natural gas is to the chemical industry . . . as flour is to a bakery. . . .
> Shale gas has been a game changer for the domestic chemical industry. For the first time in years, **U.S. chemical manufacturers have a competitive advantage over foreign chemical producers . . . This advantage is driving demand for U.S. chemical products overseas and boosting American exports. . . . . But that's only part of the story. In recent months, numerous chemical manufacturers have announced new investments thanks to the outlook for predictable domestic natural gas markets. For example, Dow Chemical Co. announced it will restart operations in facilities idled during the recession and Eastman Chemical Co. has already done so.** Executives from Bayer are in talks with companies interested in building new ethane crackers at its two industrial parks in West Virginia, ...
> A recent American Chemistry Council study found reasonable increases in shale gas production would result in nearly 400,000 new jobs in the chemical sector and supplier industries, more than $132 billion in U.S. economic output and nearly $4.4 billion in local, state and federal taxes annually.[38]

Based on the record and the public statements of chemical manufacturers in other fora, three basic facts are clear. First, the price of raw materials and feedstock – most predominantly natural gas – is the driving cost and risk factor for American chemical companies. Second, American chemical producers are enjoying a boom due to their competitive advantage over foreign manufacturers, and are *expanding* not contracting, operations in the United States. Third,

[37] NS Oral Argument Exhibits at 19 ("Dow Announces Plans to Fully Integrate and Grow North American Performance Businesses with Shale Gas Liquids"); NS Reply Comments at 37-39 (listing numerous examples of new facilities or facility expansion in the domestic chemical industry).

[38] Calvin M. Dooley, CEO of American Chemistry Council, Opinion, *Dooley: NAT GAS Act Isn't the Solution for Energy*, ROLL CALL, July 13, 2011, http://www.rollcall.com/issues/57_6/NAT_GAS_act_isnt_solution_energy-207234-1.html (emphasis added).

while chemical shippers would no doubt prefer lower rail rates, rail transportation rates are not the driving force in the chemical business or chemical companies' investment decisions such as plant closures, openings, and expansions. Actual evidence reveals the chemical manufacturers' claims in support of forced access for what they are: unsupported and erroneous pretexts for increased regulatory intervention that they believe will reduce their rail transportation rates.

E. The Evidence Undermines Allegations That Railroads Do Not Negotiate And Only Provide "Take-It-Or-Leave-It" Offers.

At the hearing, BNSF expressed dismay over hearing a customer with whom it had negotiated extensively claim that railroads refuse to negotiate but only offer "take-it-or-leave-it" offers.[39] NS was equally amazed to hear such a claim from two of its customers with whom it had recently spent months negotiating. As explained further in the attached verified statement of Alan H. Shaw, NS has engaged in extensive negotiations involving a good deal of give and take with the two chemical shippers—Dow and DuPont—that made the baseless "take-it-or-leave-it" accusation during the hearing. The verified statement details NS's give and take exchanges with those two shippers as opposed to the "take-it-or-leave-it" picture they present with no supporting evidence. Certainly there could be isolated situations where customers feel like they do not have the leverage they would like or where they cannot get a railroad to offer them the exact rate and terms they would prefer. But this evidence substantially undermines this rationale.[40]

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[39] Testimony of John Lanigan, BNSF (File 3, 02:59:25); *See also,* Testimony of Curt Warfel, National Industrial Transportation League ("NITL") (File 1, 00:38:30) ("[M]any railroads simply present shippers with 'take-it-or-leave-it' terms."); Jeff Baker, Dow (File 3, 01:38:44) (Railroads have a "'take-it-or-leave-it' attitude"); Keith Smith, DuPont (File 3, 01:46:32) (Railroad behavior "includes[s] 'take-it-or-leave-it' contract proposals").

[40] NS understands that UP also filed evidence regarding its commercial negotiations and practices pursuant to the protective order in this proceeding.

II. THE CURRENT BALANCED REGULATORY SYSTEM SERVES AND PROTECTS VALID SHIPPER NEEDS AND CONCERNS.

The Board has a multitude of process to address claims raised at the hearing. The Board provides processes, rooted in rail and market economics, through which it determines where a rail rate is unreasonable. The Board has procedures for cases to address allegations regarding a railroad's behavior. In these and other instances, the Board's procedures provide an adequate means of addressing any legitimate complaint based on actual evidence.

The hearing further demonstrated that, at bottom, most proponents of railroad regulation are really seeking one thing and one thing only, lower rates. That distilled truth was presented clearly when Chairman Elliott asked a forced access proponent if his organization would prefer forced access or rate regulation changes. The witness replied *"I think better rates frankly. That's the bottom line. You know, right now I think most of us are being served fairly well by the railroads and they're efficient and they're our partners."*[41] The Witness's candid response says it all: rail service is good but shippers want to pay less for it. Radical regulatory interventions such as forced access and forced interchange would not serve that goal because they would adversely affect the rail service Mr. Hurst praised. Far more appropriate for shippers who genuinely believe their rates are unreasonably high would be to take advantage of the current multi-tiered system for challenging rates before the Board and the options it provides to shippers.

[41] Testimony of Wayne Hurst, National Association of Wheat Growers (File 1, 03:58:01) (emphasis added).

A. The Board's Existing Procedures For Evaluating The Reasonableness of Rates And Practices Are Entirely Adequate To Address Concerns Raised By Hearing Witnesses.

The Board already has regulatory procedures in place for solely-served shippers who believe their rail rates are unreasonable: Stand-alone Cost cases (SAC), Simplified SAC for medium-sized cases, and the Three Benchmark ("3B") approach for smaller cases. The three-tiered approach affords flexibility and multiple options to shippers considering rail rate challenges. It allows shippers of different sizes and with different needs to access the Board's procedures. For Simplified SAC and 3B, the Board has adopted simple and less costly procedures to improve access to rate challenges for shippers. The Board recently further facilitated access to rate challenges by reducing dramatically the filing fee—from $20,600 to $350—for SAC cases. *See* Final Rule, STB Ex Parte No. 542 (Sub-No. 18), *Regulations Governing Fees for Services* (decided July 1, 2011).

In all cases, whether a rate is reasonable is decided based on evidence; it is not decided based on conclusory allegations or on assertions that a rate is too high. As the Board knows well, a rate for a particular move could be reasonable regardless of whether it exceeds some arbitrary R/VC ratio (such as a railroad's RSAM for a particular year). It all depends on what the evidence in the case and the economic test show.

To the extent shippers have complaints about rail carrier practices apart from rates, there are existing Board procedures and remedies that would be far more effective at resolving specific issues than forced access. 49 U.S.C. § 10702(2) provides the Board with authority over the reasonableness of a railroad's practices, an authority the Board has not hesitated to exercise where it determined such action appropriate. The Board's determination of whether a challenged carrier practice is reasonable and any remedy the Board might grant in such a case, are based on a complete presentation of the facts and supporting evidence, something woefully lacking in many of the conclusory allegations leveled against carriers during the hearing.

In such proccedings, the full facts supported by evidence might look substantially different from the allegations some witnesscs lobbed at the hearing. For example, thc North Carolina Department of Transportation ("NC DOT") asserted that the State invested in a six mile rail line to connect a new Spirit Aerospace facility to the NS system but that once it did so, NS quoted a rate that was not competitive and ten times higher than the truck rate.[42] What NC DOT's witness failed to explain, and what would be developed during a reasonable practices procceding, is the context for NS's rate offer and thc rcasoning behind it.

Spirit Aerospace manufactures fusclage sections of Airbus aircraft, which arc obviously products of considerable and irrcgular sizc, what are commonly referred to as "high-widc" traffic movements. The initial clearance proposed by thc shipper was 65' x 10' x 18.' NS's rail partner, the North Carolina Railroad, made significant improvements to accommodate that outsized movement, including relocating wires and signals. NS based its rate offer on its "Megaload" standards, which apply to freight with width greater than 13'6" or height greater than 20'3". NS offered discounts based on multiple shipments, which would have reduced the nced for multiple special trains, and withdrew the spccial train fees. However, Spirit Aerospace later expanded thc product dimensions to 18'6", greater than those NS had approved or was able to accommodate.[43]

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[42] Testimony of Jim Trogdon, NC DOT (File 1, 03:19:02).

[43] The presence of this intermodal competition would affect a rate case. The accuracy of the truck rate NC DOT referenced would also have to be explored. NS doubts that the cited truck rate is sustainable, because it is significantly lower than would be expected given the necessary parameters and services for each shipment due to the product's irregular size: police escorts are required; movement can only occur during daylight; and two lanes of a

B. Several Witnesses Assert That Access To Multiple Rail Carriers Does Not Create Acceptable Competition, Undermining The Rationale For Forced Access.

The hearing also revealed fundamental differences between groups seeking increased regulatory intervention by the Board. Some shippers contend that their rail rates are "too high" because they are directly served by only one railroad carrier, ignoring modal competition – and so they are seeking forced access to manufacture rail-to-rail competition where it has never existed.[44] On the other hand, other shippers who are served by two or more carriers complain that direct rail competition – precisely what forced access proponents seek – does not generate rates as low as they wish, so they seek some other regulatory intervention to drive down rail rates.[45] Vice Chairwoman Begeman summed up this fundamental contradiction when she noted "on the one hand we're hearing we need more competition, we need the Board to act to inject competition. Equally we're hearing from other shippers who have competition the allegation that the carriers are not competing...If it's true that [the carriers] aren't competing, to do something on reciprocal switching or bottleneck, may not give [shippers] the solution you are hoping for. I'm juggling with what the right thing to do is."[46] The evidence, including the record in this proceeding, show that rail carriers do compete, vigorously. The cross-currents in complaining shippers' testimony, however, reveals their common bottom line goal: regardless of how they frame their complaints, those shippers just want lower rates. Moreover, the tension and

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four lane highway must be closed for the oversized load. It is doubtful the low truck rate can be maintained over an extended period because the carrier will likely suffer a loss on each movement. NS is awaiting further communication as to the final specifications for the fuselage shipments

[44] *See, e.g.*, Testimony of Terry Whiteside, Alliance for Rail Competition ("ARC") ("ARC is an association of shippers that are captive to railroads for a significant portion of their freight shipments.") (File 1, 3:31:23).

[45] *See* n. 20, *supra*.

[46] Question of Vice Chairwoman Begeman (File 3, 02:43:33).

fundamental disagreement between advocates of increased regulation makes clear that the wrong thing to do would be to impose forced access on the rationale that it reduces rail rates and improves service.

Contrary to their rhetoric, forced access proponents are most assuredly not seeking de-regulation. What they are seeking, plain and simple, is lower rail rates.[47] Their goal is not increased competition or any type of market-based reform. Rather, they support any regulatory intervention possible, be it forced access, forced interchange, or rate regulation, which will artificially lower their rates at the expense of the rail network as a whole. None of these proposals constitute de-regulation. At the very least, the proposals would merely insert new regulations and requirements to the existing regulatory regime.

III. FORCED ACCESS PROPOSALS WOULD INFLICT SERIOUS HARM ON RAIL CARRIERS, THE RAIL NETWORK, RAIL SERVICE AND SHIPPERS.

The evidence in this proceeding demonstrates that forced access and forced interchange proposals would have severe, detrimental effects on the entire rail system and on all rail customers. It also demonstrates that it would undermine investment at a time when our nation needs private investment in infrastructure. Advocates of forced access and forced interchange proposals did not even attempt to address the impacts of such proposals.

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[47] *See*, n. 41, *supra* (Testimony of Wayne Hurst, National Association of Wheat Growers).

As a direct response to the numerous questions asked of Mr. Manion and Mr. Burkhardt to understand actual rail operations,[48] NS offers here clarification of certain important terms and concepts, and their proper context.

A. Car Handling By One Carrier Versus Interchange Between Carriers.

1. Handling of Carload Traffic That is Local to A Single Carrier

As NS Witness Mark D. Manion, Executive Vice President and Chief Operating Officer, explained, a typical carload merchandise car moving in "local" service (*i.e.* being moved on NS's rail network without any involvement of another carrier) is "handled" on average at least three times.[49] These handlings are very expensive and inefficient parts of railroad operations.

Although NS witness Manion explained in some detail in his oral testimony the complications of railroad operations and how allowing shippers to decide when and where shipments would have to be handled, there appeared to be considerable confusion and uncertainty about basic operating terminology and concepts. In order to bring some clarity to the subject, NS is submitting with this filing a short video that documents, explains, and provides visual documentation of each of the handlings that occur on average for a car traveling from an origin on NS to a destination on NS (of which there are three on average). *See* Exhibit C.[50] The first car handling occurs in the origin serving yard after the local freight crew picks up a load (one or more cars) at an originating industry. Picking up the car at the industry can sometimes

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[48] *See, e.g.*, Comment of Chairman Elliott ("Thank you panel for your help today, especially the operational matters. I know those matters came up quite often yesterday . . .") (File 3, 03:15:30); Question of Vice Chairwoman Begeman (questions concerning difference between interline interchanges and car handlings on single carrier's system) (File 3, 03:28:45).

[49] Testimony of Mark D. Manion, NS (File 3, 03:29:30).

[50] The descriptions set forth in these Comments and the accompanying video exhibit are illustrative and typical, but the handling of a particular individual movement may be different from that described and depicted in this submission.

be complicated itself.[51] But NS considers the first "handling" to be the sorting of the cars into blocks in the origin serving yard. Those blocks are then built into trains for forwarding on into the NS system.

A second car handling is typically conducted at a classification yard[52], which is actually three yards in one – a receiving yard, a classification yard, and a forwarding yard. A train arrives in the receiving yard, where the road locomotives are removed and yard locomotives attached. The train is then positioned such that the yard locomotive can shove the train over a hump. On the hump, an employee disconnects the cars and they are then pushed over the hump and gravity fed onto a classification track, which is typically one of a web of tracks (or a "bowl" as it is sometimes called). Cars bound for the same next stop within the NS system are all sent to the same track in the classification yard. The blocks of cars created in each of the classification tracks are then reassembled into new trains in the forwarding yard.

To minimize costly switching and handling, Norfolk Southern (like other carriers) has developed sophisticated computerized blocking and service design systems. Nevertheless, some cars must go through this process in multiple classification yards in order to reach their final destination. In some instances, this results in cars being directed to a yard that may not be the

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[51] Frequently, the local train serving the industry will also deliver empty cars and incoming loaded cars in the same trip. Further complicating the process of picking up and setting off cars at an industry is the fact that the cars to be picked up are sometimes intermixed with empty cars and that the orientation of an industry siding or placement of cars may require "runarounds" or other complicated maneuvers. Thus, for example, a local origination may involve removing multiple cars from a track, setting over the load to be pulled, adding cars to be placed to a string of cars to be returned to the industry track, and then re-spotting the track with all cars in the proper location. *See, e.g.*, JOHN ARMSTRONG, THE RAILROAD, WHAT IT IS, WHAT IT DOES 203-205 (5TH ED. 2008) ("*The Railroad, What it Is, What it Does*") (providing more detailed description and diagrams of origination switching and handling).

[52] Cars frequently move through other intermediate yards, such as origin serving yards, receiving yards, and forwarding yards. Some handling and classification may be done at these yards, but NS endeavors to minimize additional handling activity at such yards.

one most geographically proximate to the ultimate destination. As one expert commentator explained:

> It may make sense to send a car out of route for a day or ultimately backhaul it for a day if that routing saves overall transit time or reduces en route switching of the cars or both. . . . The computer system may assign cars to a block after considering all of the available shipments throughout the system that are destined to a general area and the workload of several candidate yards at the time that the various trains handling the shipments will arrive.[53]

The third car handling in a typical movement is at the destination serving yard, where cars arrive and are sorted onto local trains. Such destination handling generally involves switching a car or block of cars out of a train, and delivering the car(s) to the receiving industry. The handling activities for a termination – maneuvering, setting out, and positioning cars – are essentially the same as those described above for a movement origination.

2. <u>Interchanging Traffic Between Carriers</u>

Interline carload traffic requires interchanging of rail cars between carriers, which entails substantial additional effort, time, and expense to the carriers. Mr. Manion provided a substantial verified statement describing some of the difficulties associated with injecting additional, unnecessary handlings through forced interchange and forced access. In short, those issues include: (1) additional handlings; (2) inadequate infrastructure to handling such operations; (3) the risk of stranded assets; (4) disincentives to investment; (5) replicating the most inefficient aspects of operations; and (6) additional safety risks.

Witness Manion explained that efficient rail service design and operations depend on taking account of and controlling as many significant variables as possible, and efficiently

[53] *The Railroad, What it is, What it Does* at 217.

allocating of system resources (infrastructure, crews, equipment, etc.) based on known and predictable events, traffic flows, conditions, and circumstances. Allowing numerous diverse shippers to dictate routing, interchange points, whether a movement will be single line or interline, and other operational parameters based on each shipper's specific wishes and narrow self-interests would make efficient rail system planning and execution far more difficult. In aggregate, the compound effect of numerous shippers narrowly-focused routing, interchange and access demands would inevitably erode service and efficiency for all shippers. If shippers were allowed to change their routing and interchange choices and requirements whenever they wished, carriers' ability to plan and design efficient service systems would be severely impaired. The likely result would be substantial erosion in the quality of rail transportation service and rail system capacity and efficiency.

The only attempt any party made to respond to the problems identified by NS was a statement by Mr. McDonald on behalf of the Concerned Captive Coal Shippers.[54] But Mr. McDonald did not even address carload traffic. His statement primarily addresses unit trains. And even for unit trains, NS belives Mr. McDonald's testimony understates and underestimates the operational inefficiencies and complications involved in forced switching and interchange.

In sum, the evidence submitted in this proceeding demonstrates that allowing customers to specify new interchanges, or to insert interchanges to a route where NS (or another single carrier) provides single-line service could be very disruptive, reduce the efficiency of NS's existing service, and cause broad negative effects on service throughout the NS system. As demonstrated in this proceeding, individual shippers who seek forced interchange on demand

[54] Reply Comments of the Concerned Captive Coal Shippers, Verified Statement of Richard H. McDonald.

want that power primarily to reduce their rail transportation costs or gain other commercial advantage for their freight. While this narrow focus of specific shippers is not surprising, it is not consistent with a rail carrier's broader objective of delivering the most efficient overall services to its customers and maximizing efficiency across the system. In many instances, an alternative routing or interchange that is most desirable for one shipper may create substantial service problems for other shippers and reduce the efficiency of the network, thereby causing net harm to shippers and their customers.

B. The Rail Competition Study Conducted For The Board Did Not Advocate Forced Switching.

Several witnesses suggested that the Christensen Report endorsed "reciprocal switching," and urged the Board to adopt new forced switching regulations as a way to increase rail competition without detrimental effect on the rail industry. *See, e.g.,* Testimony of Jeffrey Moreno, Interested Parties (File 1, 01:05:50) ("I think it's telling that even in the Christensen Report that was prepared for the Board, reciprocal switching was identified as probably having the greatest benefit with the least cost to the rail industry. Therefore, that provides an opportunity to enhance competition with the least risk from the Board's perspective.") *See* Initial Comments of NITL at 11; Initial Joint Comments of Alliance for Rail Competition et al at 38-39. These claims misread the Christensen Report, ignore the context of the analysis, and fail to apprehend the potential harm to rail operations and service that could result from imposition of broadly available forced switching.

First, the Christensen Report did not recommend that the Board adopt any new form of forced access. Rather, it discussed potential economic effects of several forced access proposals (including bottleneck rates, reciprocal switching agreements, terminal access agreements and trackage rights) that had been included in congressional and other proposals – none of which even progressed as far as a vote on the floor of either house of Congress. *See* 3 Laurits R. Christensen Associates, Inc., *A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals That Might Enhance Competition* (2009), Christensen Report at 22-4 to 22-14.

Second, the Christensen Report's assessment of economic effects of open access proposals was expressly based upon the assumption that the terms of access are:

> *determined through voluntary negotiations between railroads*, with STB oversight of the process. To the extent that the terms of access are set according to some legislative or regulatory formula that results in outcomes that differ from the terms resulting from voluntary negotiations, the economic effects of these open-access proposals becomes less predictable.

3 Christensen Report 22-12 (emphasis added). The forced switching proposals advocated by shippers here would require switching at the request of a shipper, not based upon voluntary carrier negotiations. As the authors of this portion of the study explained in their testimony responding to shippers' erroneous and exaggerated claims concerning the study's conclusions about reciprocal switching,

> [t]he assumption that the terms of access reflect the result of *voluntary negotiations* implies that such an outcome produces a net gain in economic efficiency. . . . [F]or an open access policy to produce an overall economic welfare gain, it must generate a voluntary competitive response by railroads. . . . The construct of voluntary negotiations provides an economically principled benchmark for establishing terms of access that produce gains in economic efficiency. . . . [A]n important implication of this is that the success or failure of open access policies greatly depends on how the terms of access are determined.

AAR Reply Comments, Joint Verified Reply Statement of B. Kelly Eakin and Mark E. Meitzen, Christensen Associates at 11-12 (May 27, 2011) (emphasis added). In other words, the key to the Christensen Report's assessment of reciprocal switching is that it is *voluntary*, and its terms are the product of voluntary negotiations between the affected carriers. Under current policy and regulations, rail carriers already have the option of negotiating voluntary reciprocal switching arrangements and agreements. And, where the economics work and are not offset by operational or other issues, carriers do voluntarily enter into reciprocal switching arrangements today.

Continued authorization of such voluntary switching arrangements is reasonable and appropriate. However, what some shippers are proposing would not be voluntary[55] – instead they propose that forced switching be mandated by law or regulation, with terms (including access pricing) determined by the Board if necessary. Absent the voluntary negotiation assumption underpinning the Christensen analysis, the proposal would lack the "economically principled benchmark" necessary to the projection that such switching access could produce an economic welfare gain. *See id.* at 12.

Third, the Christensen analysis did not consider operational issues and effects of forced access proposals. Thus, the analysis entirely ignores one of the most important considerations highlighted in the comments and testimony of the rail carriers: the very significant potential operational effects of forced switching and other forced access, and their concomitant effects of rail service and efficiency. *See, e.g.*, NS Opening Comments, V.S.; UP Comments, V.S. Lance M. Fritz; Testimony of M. Manion (June 23, 2011).

Fourth, far from recommending the adoption of a new forced switching policy, the Christensen Report simply indicated that – based on its assumptions, including voluntary negotiated terms – reciprocal switching *agreements* (not forced switching) would likely be among "the least costly in terms of loss of economic efficiency" of the various open access proposals. *See* 3 Christensen Report at 22-13. Further, the Report cautioned that "the distributional effects [of forced access] among shipper groups as well as between shippers and railroads" should be important "primary considerations." *Id.* at 22-14. As the authors explained, they "concluded that relief to one group would imply negative consequences to other groups (either shippers and/or railroads)." AAR Reply Comments, Joint Verified Statement, Eakin and Meitzen at 13. Thus, the Christensen Report did not even conclude that increased reciprocal switching would confer a net economic benefit to shippers, let alone recommend adoption of a forced switching policy.

C. Forced Access Advocates Did Not Address The Reduced Investment That Would Likely Result From Lower Rates For Some Shippers.

Although several shipper commenters urged the Board to implement forced access regulations and take other actions to reduce rail rates[56], none of those shippers provided any meaningful testimony concerning the direct relationship between rail revenues and rail carrier capital investment in their systems, facilities and equipment. Rail carriers' ability to invest in their systems is directly related to their earnings.. As the data clearly shows, higher rail carrier earnings result in higher capital expenditures by these carriers. *See, e.g.*, Exhibit D (AAR Chart Entitled "Higher Rail Earnings = Higher Rail Capital Spending"). Lower rail revenues

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[55] Because such access would not be voluntary but would be forced by government fiat, NS calls these proposals forced access and forced interchange.

[56] *See, e.g.*, Testimony of Tom Schick, American Chemistry Council ("[E]nhance competition in the following specific areas...inject needed intramodal competition within rail terminal areas by revising the reciprocal switching regulations established many years ago. By reversing *Midtec* precedent, which requires anti-competitive conduct to be established and therefore limits the statutory provision for competition in terminal areas, and generally to encourage rail-to-rail competition...") (File 2, 01:48:50); Testimony of Fred Fournier, M&G Polymers USA LLC ("M&G") ("The Board can and should modify its existing policies to facilitate such competition through the requested reciprocal switching and bottleneck rates..") (File 3, 04:11:55).

inevitably mean lower capital expenditures and investment in the rail network. Every $ 1 billion dollars of rail carrier capital expenditures generates 17,000 – 20,000 jobs.[57] Rail labor organizations recognize the direct links between rail earnings and rail capital investments and jobs, and they urged the Board not to take actions that could reduce railroad investment and employment.

D. Many Shippers And Other Participants In The Proceeding Support The Current Rail Regulatory Rules, Law, And Policy.

Testifying in favor of increased regulatory intervention one witness proclaimed that "[n]o shipper supports...the Board's currently policy."[58] The record strongly refutes that careless misrepresentation. Unfortunately, this is simply a particularly clear example of forced access proponents' practice of making sweeping, unsupported allegations and conclusions that cannot withstand scrutiny. Contrary to the testimony of the "Interested Parties" witness, many shippers from various sectors of the economy spoke in favor of the Board's current policies because they have been effective in facilitating continued reinvestment in the rail network. Moreover, as documented in multiple Comments, rail rates that shippers pay have declined since the Staggers Act, while service has simultaneously improved.[59] Despite the comments of a small minority seeking lower rates for themselves at the expense of the rail transportation system as a whole, the current, balanced regulatory approach has truly been a win-win situation for the railroads and shippers. Many other commenters, such as economic development agencies, state and local officials, and the Chairmen and Ranking Members of the House Committee on Transportation

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[57] This is an AAR estimate based on government data. The range of 17,000 – 20,000 reflects different job generation rates for different types of capital investments.

[58] Testimony of Michael McBride, Interested Parties (File 1, 01:00:39).

[59] *See, e.g.,* Initial Comments of Canadian Pacific Railway Company at 12-15.

and Infrastructure and the Subcommittee on Railroads, Pipelines & Hazardous Materials, also expressed strong support for the current regulatory rules, laws, and policies. These comments and many others strongly support the present system and oppose forced access and other new regulatory interventions because they recognize the economic benefit of a well functioning national rail system.

During the hearing, the Board heard from shippers who support the current, carefully crafted regulatory system. Christopher Marsh of CONSOL urged the Board to "please be careful" and asked it not "do anything that will create enough uncertainty that capital investment will be hesitant."[60] George Macko testified on behalf of USG in support of the current system. As Mr. Macko explained, the critical measure with respect to railroads is not whether rail carriers are generating net earnings, but whether they are reinvesting those earnings into the rail network. USG's view is that the railroads are reinvesting their profits in the rail system in a beneficial manner.[61] USG also warned against the siren song of forced access because "as attractive as some of these ideas may sound on the surface, they cannot be pursued and implemented at the potential expense of the railroads' investing for the shipping community and the nation's future."[62] David Yeager, CEO of the Hub Group, a transportation logistics company, warned that while increased rail regulation might benefit a few individual companies, it would cause broad harm to other shippers and the public at large.[63]

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[60] Testimony of Christopher Marsh, CONSOL (File 3, 01:15:23).

[61] Testimony of George Macko, USG ("In our opinion, the issue here is not about the level of railroad profits, are they fair, but rather are the railroads responsibly reinvesting those profits for the benefit of the shipper community and the country. Our answer to that is emphatically yes and they should continue.") (File 3, 04:17:05).

[62] Testimony of George Macko, USG (File 3, 04:31:52).

[63] Testimony of David Yeager, the Hub Group ("[A] few railroad customers, in specific rail markets, who ship specific kinds of freight, believe that expanded rail regulation will benefit their own self interests. However, such a

In addition to those parties that testified in support of the current, balanced regulatory regime at the hearing, many more parties submitted comments in support of the current regulatory system and opposing proposed changes.[64] Shipper support for the Board's current regulatory approach came from many sectors of the economy including: forest products;[65] agriculture;[66] building materials;[67] coal;[68] and gypsum.[69] In general, these shippers all recognize that the increased regulatory interventions proposed by a small minority "would discourage private investment" in the rail network.[70]

Many other commenters also support the current regulatory structure. Perhaps most notable are the many economic development agencies that submitted comments because they were troubled by the potential effect of forced access and forced interchange on local business development efforts, which are crucial to getting the U.S. economy moving again. The St. Louis Regional Chamber & Growth Association summarized the concerns of many, commenting that "[e]ncouraging the freight railroads to make new investments in their systems will lead to new job creation, improved reliability and service as well as provide a cost effective and environmentally friendly means for the transport of goods...Policies or regulations that would

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shift will do harm to many more companies and individuals in the long run. Taking actions that could reduce railroad efficiency will harm the interests of intermodal customers, as well as the public at large who benefit from the railroads.") (File 3, 01:06:28).

[64] NS's Reply Comments summarized in more detail the broad range of parties supporting the Board's current regulatory approach and/or opposing new regulatory intervention. *See* NS Reply Comments at 8, 11-16, 25-27.

[65] *See, e.g.*, Comments of Beasley Forest Products, Inc.

[66] *See, e.g.*, Comments of: Cagle's Inc.; South Milford Grain Company; Topflight Grain Coop; Interstate Commodities, Inc.; and Sunrise Cooperative.

[67] *See, e.g.*, Comments of: Big River Industries, Inc.; Associated Asphalt; and Rosboro, LLC.

[68] *See, e.g.*, Comments of: Robindale Energy Services; Rosebud Mining Company; James River Coal Company; South Carolina Electric and Gas Company; Teco Coal Corporation; Xcoal Energy & Resources.

[69] *See, e.g.*, Comments of Jimco.

diminish or inhibit the freight railroads ability or desire to invest would surely have a negative impact on economic development."[71] Similar comments were submitted by economic development authorities and government officials, including governors, from across the country.[72]

As with many witness claims at the hearing, the assertion that *no* shipper supports the current policies of the Board is unsupported and collapses under scrutiny. Indeed, shippers from many sectors of the economy not only support the current, balanced regulatory posture of the Board, but expressed that support by taking the time to participate in this proceeding. As NS explained in its Reply Comments, the issues the Board is considering "pit selected groups of shippers against the interests of a diverse group of other shippers, railroads, and other stakeholders. Although a few shipper groups…seek to advance their narrow self interests by advocating radical regulatory change and increased government intervention, most shipper commenters oppose such ill-advised changes."[73] Other parties with a large stake in the outcome

[70] Comments of Topflight Gain Cooperative.

[71] Comments of St. Louis Regional Chamber & Growth Association.

[72] *See, e.g.*, Comments of: Altoona-Blair County Development Corporation; Columbus Regional Airport Authority; Cherokee County Development Board; Governor Tom Corbett; Governor Nathan Deal; Franklin County Area Development Corporation; Grant County Economic Growth Council; Greater Hazelton Can Do; Harrison County Economic Development Corporation; Hampton Roads Economic Development Alliance; Joint Industrial Development Authority of Wythe County, Wytheville, and Rural Retreat; Miami County Economic Development Authority; Monroe County Industrial Development Corporation; New Castle Henry County Economic Development Corporation; Ohio Department of Development; Pittsylvania County Department of Economic Development; Putnam County Development Authority; Roanoke Regional Chamber of Commerce; Southwestern Michigan Economic Growth Alliance, Inc.; South Carolina State Ports Authority; Steuben County Industrial Development Agency; Southern Tier Economic Growth; Shenandoah Valley Partnership; Warren County Office of Economic Development; UpState SCAlliance; Broward County Florida, Port Everglades; KCSmartPort; Office of Economic Development, Danville, Virginia; Knoxville Chamber; New River Valley Economic Development Alliance; Port of Miami; Warren County Local Economic Development Organization; Waterfront Coalition; The Columbus Region; Jackson County Economic Development Authority; Comments of Jacksonville Chamber of Commerce; Comments of Great River Economic Development Foundation.

[73] NS Reply Comments at 25.

of this proceeding, such as economic development agencies, support the Board's current approach and oppose forced access or other increased regulation. These parties recognize the importance to all stakeholders of continued rail network reinvestment, particularly given the expectation of substantial future growth in rail freight volumes.

IV. THE BOARD DOES NOT HAVE POWER TO ADOPT THE PROPOSED REGULATORY CHANGES ADVOCATED AT THE HEARING

Several witnesses at the hearing advocated the adoption of new forced access regulations.[74] Others advocated the adoption of alternative rules that were not included in the Board's notice, are not within the scope of this competition hearing, or both. What these proposals have in common is that they are outside the Board's authority to adopt without further congressional authorization. Congress has repeatedly and uniformly refused to adopt the regulatory changes proposed in this proceeding. Indeed, since the passage of ICCTA alone, Congress has considered at least 16 bills that would amend the law to provide for various types of forced access. *See* NS Opening Comments at 20-28 & Appendix. In every single instance, Congress declined to pass the bill that would have changed the law or the Board's regulations and precedents, thus rejecting forced access and ratifying existing law, regulations, and policies. *See id.*

A. Congress' Ratification of Board Interpretations and Applications of the Law Strictly Limits the Board's Ability to Change Them Unilaterally.

Senator Rockefeller testified at the hearing that, because Congress was unable to pass a law providing for open access or forced access, it was up to the Board to enact such changes.[75]

[74] *See, e.g., supra* n. 54.

[75] *See, e.g.,* Testimony of Senator J. Rockefeller ("[T]he Congress is not functional right now...I move away from the idea of legislation just a bit because nothing will happen...I think that shifts more of the Senate's responsibility to the Surface Transportation Board.") (File 1, 02:04:27).

With respect, the Senator's suggestion would flout constitutional separation of powers and misapprehends the basic division of responsibilities among the branches of the federal government. It is the exclusive province and responsibility of Congress, the Legislative Branch of the government, to enact laws. The function of Executive Branch is to apply and enforce – to "execute" – the laws enacted by Congress. Executive agencies may not make or change federal laws. Executive branch authority to change the law through "interpretation" or regulation is inappropriate where the legislative branch has considered and rejected the very same changes. Contrary to Senator Rockefeller's suggestion, Congress' rejection of the proposals under examination in this proceeding is not an invitation for contrary regulation by the Board, but rather it *precludes* such regulation.

As NS established in its comments, the Board lacks authority to change implementing regulations and policies concerning through routes, the very longstanding prohibition against short-hauling, reciprocal switching, terminal access and trackage rights, and other proposals at issue in this proceeding, because Congress has considered and ratified those interpretations and applications of the law. *See* NS Opening Comments at 14-28 and Appendix; NS Reply Comments at 5-10. In opposition to this argument, some witnesses and commenters argued that the Board has authority to reverse existing access rules and policies, under the general rule that an agency may reverse or change its policies and regulations, if it provides a reasoned explanation for the change. *See, e.g.,* Testimony of Michael Loftus, Concerned Captive Coal

Shippers (File 2, 0:21:20); Testimony of Tom Schick, American Chemistry Council (File 2, 01:48:08).[76]

The arguments made on behalf of this group of shippers misses the point. They are correct that the general default rule is that, absent strong evidence of contrary congressional intent, agencies may change policies implementing their statutory responsibilities, so long as they provide an adequate, reasoned explanation and justification for the reversal and the new policy is consistent with the direction and requirements of the statute. *FCC v. Fox Television Stations, Inc.*, 129 S.Ct. 1800, 1811 (2009).

NS's point is that the general rule applied in *Fox* does not apply in the present exceptional circumstances; rather a separate line of Supreme Court cases applies. What NS and other commenters established, is that there *is* strong evidence of congressional intent to maintain the existing interpretation and application of governing law. The abundant, compelling evidence of congressional ratification of existing ICC and STB policies implementing the agencies' statutory authority shows that those policies are within the *exception* to the general rule, which the Supreme Court has repeatedly applied and severely constrains the Board's authority to change those policies. *See generally* NS Opening Comments at 14-28 & Appendix; NS Reply Comments at 5-10; CSXT Opening Comments at 2-10; CSXT Reply Comments at 24-33.

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[76] *See also*, Joint Reply Comments of ARC, American Chemistry Council et al at 44-48; Reply Comments of Westlake Chemical Corporation at 4-6. NS agrees with former Congressman English in one respect. He indicated in his testimony that if the Board does not have to make changes advocated in this proceeding, but it wishes to consider such changes, the way to proceed would be to seek such authority from Congress. *See* Testimony of Glenn English, CURE ("I know that others have argued against addressing those issues, saying that you don't have the authority to do so. . . . I would suggest and urge this commission they have a responsibility if they think they're lacking in authority to go to the Congress and see if the Congress isn't willing to expand it if you think it's necessary.") (File 2, 00:07:26).

As NS and other commenters explained, the evidence shows that in the process of enacting ICCTA, Congress carefully considered nearly all of the agency policies and regulations (which the ICC adopted to implement the Commerce Act) under consideration in this case. In enacting the comprehensive overhaul of the Commerce Act (which included abolition of a federal agency in existence for more than 100 years), Congress consciously decided not to change the competition and access policies at issue in this proceeding. By enacting ICCTA without changing those policies, Congress ratified and adopted those policies. Under such exceptional circumstances, an administrative agency such as the Board may not materially change the policies and regulations adopted and cemented by Congress unless and until Congress acts to change the law. *See, e.g.,* CSXT Open. Comments at 6-10; *FDA v. Brown & Williamson Tobacco Corp.,* 520 U.S. 120, 155-56 (2000); *United States v. Riverside Bayview Homes, Inc.,* 474 U.S. 121, 137 (1985).

Importantly, despite numerous efforts by forced access proponents over the intervening 15 years – including at least 16 bills providing for imposition of forced access, the reversal of *Midtec Paper Corp.*, 857 F.2d 1487 (D.C. Cir. 1988), the bottleneck rule, and other policies at issue in this proceeding—Congress has repeatedly rejected all legislative proposals to change those well-established, sound and judicially ratified policies and regulations. *See* NS Opening Comments at 14-28 & Appendix; NS Reply Comments at 5-10. Thus, not only has Congress not changed the law it ratified in ICCTA, after repeated, careful consideration of the policies at issue here (including numerous hearings addressing these very issues and policies), it has flatly and resoundingly rejected any change to those policies. As NS previously established, this extraordinary legislative record is powerful evidence of congressional acquiescence in, and support for existing access law, rules, and policy and rejection of proposed reversal of those policies. *See id.; see also*, *Bob Jones University v. United States,* 461 U.S. 574, 600 (1983); *Canada Packers, Ltd. v. Atchison, Topeka & Santa Fe Ry. Co.*, 385 U.S. 182, 184 (1966) (upholding longstanding ICC rule implementing Commerce Act, in view of fact that "Congress, which could easily change the rule, has not yet seen fit to intervene").

Contrary arguments advanced in this proceeding by forced access advocates do not effectively address the law (summarized above and described in detail in the primary comments of NS and others) concerning congressional ratification and adoption of agency implementing regulations and policies, including the Supreme Court decisions in *Brown & Williamson*, *Bob Jones University*, and *Canada Packers*. Although several commenters rely heavily on *FCC v. Fox,* none even claims that *Fox* overrules *Brown & Williamson, Bob Jones University, Canada Packers* or other congressional ratification precedents and rules.[77]

Oddly, some forced access and forced interchange advocates contend that they are seeking "to fully deregulate the railroad industries."[78] Of course, complete deregulation is outside the purview of the Board. It would require an act of Congress and would, presumably, involve the elimination of the Board. What the forced access and forced interchange proponents are really seeking is <u>not</u> deregulation, but rather <u>increased</u> regulatory intervention. Freight railroads and the rail networks are privately funded and privately owned. Forced access proponents are asking the Board to require the railroads to allow their competitors access to and

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[77] As NS explained elsewhere, the bottleneck rule – which was issued shortly after the passage of ICCTA – was essentially an application of existing, pre-ICCTA law and rules to a particular situation. Moreover, other rules and law (including *United States v. Great Northern Ry. Co.*, 343 U.S. 562 (1952)) preclude the Board from reversing the bottleneck rule without an act of Congress authorizing such a change. *See* , *e.g.*, NS Opening Comments at 6-14, 22-29 & Appendix.

[78] Testimony of Scott Stone, Interested Parties (File 1, 20:28:00). Senator David Vitter of Louisiana also argued that "the proposition is moving an industry from its protected, regulated system to a competitive system." (File 3, 21:10:00).

use of their networks, facilities, and equipment.[79] It almost goes without saying that a chemical manufacturer would vociferously oppose such government imposed access to its private facilities by one of its primary competitors. Dow would not support a government agency order requiring it to allow DuPont to use its Louisville, Kentucky plant so that DuPont would have "open access" to ethyl acrylate manufacturing and customers in that region.

Contrary to their rhetoric, forced access proponents are most assuredly not seeking de-regulation. What they are seeking, plain and simple, is lower rail rates.[80] Their goal is not increased competition or any type of market-based reform. Rather, they support any regulatory intervention possible, be it forced access, forced interchange, or rate regulation, which will artificially lower their rates at the expense of the rail network as a whole.

B. Several Proposals Proffered at the Hearing Would Directly Contravene Express Statutory Terms and are Therefore Flatly Prohibited.

Several hearing witnesses made proposals that are clearly prohibited by law. For example, a witness for WCTL proposed that the Board eliminate the qualitative market dominance test and rely entirely on quantitative market dominance analysis to determine if the Board has jurisdiction over a rate case.[81] In the first instance, rate reasonableness challenges and Board standards for measuring rate reasonableness are outside the scope of this proceeding, which the Board opened to consider "the current state of competition in the railroad industry and possible policy alternatives to facilitate more competition" Notice, STB Ex Parte No. 705,

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[79] And despite the claims of one party testifying, the railroads typically purchased their own rights of way (land grants notwithstanding) and in all cases have made the capital investment necessary to maintain them. Railroads are not highways because they are not publicly held property. As a shipper witness explained, "these are private rail networks owned and built by the railroads." Testimony of George Macko, USG (File 3, 4:29:02).

[80] *See*, n. 41, *supra* (Testimony of Wayne Hurst, National Association of Wheat Growers).

Competition in the Railroad Industry at 1 (Jan. 11, 2011). Changing rate reasonableness standards to make them more favorable to complainants is a proposal to reduce selected rail rates, *not* a policy alternative to facilitate more competition. *See id.* at 3-7 (listing and describing competition matters at issue in this proceeding, none of which is rate case proceedings or standards).

Moreover, standards and methodologies for rate cases have been thoroughly examined and revised by the Board in recent years. *See*, STB Ex Parte No. 646, *Simplified Standards for Rail Rate Cases*; STB Ex Parte No. 657, *Major Issues in Rail Rate Cases*. The only thing that WCTL's proposal might facilitate is more rate cases based on a less rigorous determination of the statutory jurisdictional requirement that the carrier have market dominance over the traffic at issue. Regardless, WCTL's proposal would violate the Commerce Act. *See* 49 U.S.C. §§ 10707(a) (market dominance means "an absence of effective competition . . . for the transportation to which a rate applies."); 49 U.S.C. § 10707(d)(2)(A) (finding of R/VC greater than or equal to 180 percent "does not establish a presumption that—such rail carrier has or does not have market dominance over such transportation). This is consistent with the well-established proposition that the 180 R/VC simply establishes a necessary but not sufficient threshold jurisdictional test, and a floor on any rate prescription. WCTL's proposal is barred by statute.

A witness for Olin Corp. and comments submitted by several shippers and the United States Department of Agriculture ("USDA") proposed the imposition of an R/VC cap as a rail rate ceiling, in place of the CMP methodology the Board has developed and refined over the

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[81] *See* Testimony of Peter Pfohl, WCTL (File 2, 00:47:34). Chairman Elliott later described the approach advocated

course of the last 25 years. *See, e.g.*, Testimony of John McIntosh, Olin Corp. (File 3, 02:12:17); USDA Reply Comments at 15. Again, this proposal is outside the scope of this proceeding. As these commenters should be well aware, the Board just recently completed two major rulemaking proceedings that streamlined SAC cases and established two less-complex and less-costly rate challenge methods. *See* STB Ex Parte Nos. 646, 657 (*Simplified Standards* and *Major Issues in Rail Rate Cases*). Indeed, one of those proceedings has not yet been completed, as it is pending before the Board on remand from the D.C. Circuit. The time and place for proposals for major changes to the Board's rate case procedures was in those proceedings, not in a proceeding concerning rail competition and policy alternatives to facilitate additional competition.

In any event, wooden application of an arbitrary R/VC cap would fail entirely to consider the factors the Board is required to consider in determining a maximum reasonable rate, *See* 49 U.S.C. §§ 10101(1)-(3); 10709(d)(2); 10704(a)(2). Moreover, the policy implications of jettisoning SAC and CMP – which are animated by bedrock differential pricing principles and rail economics as well as policy goals such as revenue adequacy – would be staggering. As the D.C. Circuit aptly noted in rejecting a similar ICC proposal to "jettison CMP/SAC" in favor of R/VC cap approach, changing to such an approach lacks "any glimmer of supporting principle or intellectual coherence." *See Burlington Northern R.R. v. I.C.C.*, 985 F.2d 589, 597-98 (D.C. Cir. 1993) (further finding that "[t]he principle for limiting the higher rates has no evident connection to any of the goals that . . . CMP/SAC was designed – indeed, well designed – to achieve."). *Id.* Simplistic application of R/VC caps as a rate reasonableness measure is a bad idea whose time has long passed.

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by Witness Pfohl as "jumping over the qualitative" market dominance test.

Finally, some witnesses proposed that shippers should not be required to pay the rail rate they are challenging during the pendency of their challenge.[82] As with the other proposals discussed in this section, this addresses rate cases and rate standards, matters which are not at issue in this proceeding and which the Board has addressed recently through full notice-and-comment rulemakings. Moreover, the proposal would violate the Commerce Act by depriving carriers of their statutorily guaranteed rate initiative and their established right to establish, charge and collect any rate unless and until it is found unreasonable. *See* 49 U.S.C. § 10701(c). While the ICC once had authority to "suspend" rail common carrier rates during the pendency of a challenge, Congress gradually eliminated that authority beginning with the Staggers Act. Ultimately, in a key provision of ICCTA, Congress repealed entirely the ICC's former power to suspend rail rates. As the Board has summarized,

> [I]n [ICCTA], Congress further facilitated railroads rate-making initiative by repealing the rate suspension procedures under which rate adjustments were sometimes prohibited from taking effect without first being investigated.

Decision, *Arizona Pub. Serv. Co. v. BNSF Ry. Co.*, STB Docket No. 42077, slip op at 7 (Oct. 14, 2003). Simply put, the Board does not have authority to suspend rates during the pendency of a rate case, and an act of Congress would be required to create that authority.

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[82] *See, e.g.*, Exchange between Michael McGarry, PPG and Commissioner Mulvey:

McGarry: "If I could tell you the biggest reason why [rate cases cost so much is] you have to go from a contract rate to a tariff rate so the rate goes up an exponential amount. And you have to pay that tariff rate until such time as the Board-"

Commissioner Mulvey: "But you get paid reparations don't you?" (File 3, 02:20:34);

Testimony of Fred Fournier, M&G ("It's totally unfair today though," concerning paying tariff rates during the pendency of a rate case) (File 3, 04:38:00).

CONCLUSION

There is no evidence in this proceeding to justify any of the regulatory changes that have been proposed. Sound policy, the law, the facts, and the evidence all point to one conclusion: The Board should terminate this proceeding without taking any further action.

Respectfully submitted,

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Dated: July 25, 2011

BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE 664

METHODOLOGY TO BE EMPLOYED IN DETERMINING THE RAILROAD INDUSTRY'S COST OF CAPITAL

WRITTEN TESTIMONY OF
NORFOLK SOUTHERN CORPORATION

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Dated: November 27, 2007

Exhibit A

BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE 664

METHODOLOGY TO BE EMPLOYED IN DETERMINING THE RAILROAD INDUSTRY'S COST OF CAPITAL

WRITTEN TESTIMONY OF
NORFOLK SOUTHERN CORPORATION

Norfolk Southern Corporation ("Norfolk Southern") provides these comments for the Board's hearing in Ex Parte 664, which is a rulemaking to address the methodology to be employed in determining the railroad industry's cost of capital.

Railroads must be attractive to investors. It has been a long time since it last occurred, but one does not have to stretch the imagination very far to see a time when railroads may have to approach equity markets to be able to make the size investment in infrastructure that the recent Cambridge Systematics, Inc., study predicted will be required. If the projections of growth in freight demand come true, railroads will quite probably need to go to the equity market to raise funds to grow their infrastructure to handle the projected increases. But railroads will not get the necessary funding from the equity market if investors view railroads as being unattractive, capped at an artificially low rate, unwilling or unable to return investors a fair return on their investment, or some combination thereof.

Exhibit A

The core question is whether an investor would invest in an industry with what could be seen as a regulatory-prescribed seven or eight percent return (which is not guaranteed) that (1) has high fixed costs and long-lived assets; (2) has most of its business subject to intense competition and the remainder subject to potential rate caps imposed by the government; (3) faces risks that legislation or regulatory changes could undermine the industry; (4) is forced to assume risks related to the transportation of commodities that it is required by the government to transport; and (5) faces ordinary business risks associated with the health of its customers and their industries. Certainly, railroads work to address and minimize these risks and take steps to make themselves more attractive to investors – just as any company does. But, setting the industry's regulatory cost of capital too low will undercut those efforts and adversely affect the railroads' ability to raise money from the equity markets, if and when they need to do so.

In these comments, Norfolk Southern will discuss the need for railroads to have access to capital to fund capacity expansion to meet the nation's transportation needs. Next, it will examine why setting the industry's regulatory cost of capital too low will adversely affect a railroad's ability to raise the money that will likely be needed to fund expansion. Actions that deter private money from being available to railroads at reasonable terms will leave a greater burden for government to shoulder and may not be the best public policy. Norfolk Southern will then address the relative risks of understating and overstating the railroad industry's cost of capital. Finally, Norfolk Southern will address the Board's proposal to jettison its long-standing use of the discounted cash flow ("DCF") method in favor of the more subjective capital asset pricing model ("CAPM"). In particular, Norfolk Southern contends that the Board should reconsider its decision not to use its long-tenured DCF model; but at a minimum, the Board should not rely solely on CAPM because it involves substantially more subjectivity than DCF.

Because the Board's notice for this hearing focused exclusively on the cost of capital, Norfolk Southern will not discuss at length the issue which is of at least equal importance – the use of replacement costs when determining a railroad's asset base. When we are considering whether to make new investments or to replace or abandon a line, Norfolk Southern reviews replacement cost data because historic costs often reflect only a fraction of the current cost of replacing those assets. Replacement costs are critically important to our business at all times, but are particularly important in these times when public policy must promote expansion of railroad capacity to meet the nation's transportation needs. As Norfolk Southern noted in its earlier comments in this proceeding, the Board should use replacement costs in its annual revenue adequacy determination.

I. THE BOARD SHOULD BE CONCERNED ABOUT THE RAILROAD INDUSTRY'S ABILITY TO ATTRACT AND RETAIN CAPITAL.

There is an important backdrop to these proceedings. Recent growth in demand for freight transportation, projections of tremendous further growth in demand for freight transportation over the coming decades, the desire for railroads to invest in the capacity to meet that need, and the ability of railroads to generate returns and access and retain capital sufficient to invest in that capacity comprise that backdrop. Discounted cash flows, betas, market risk premiums, risk free rates, and the like are important; having railroads attractive enough financially to access capital, potentially through the equity markets, to invest in the capacity to meet the future demands for freight transportation is critical.

All parties agree that railroads will need increased capacity to maintain and improve service. The demand for freight transportation has grown and is projected to continue to grow. The United States Department of Transportation ("U.S. DOT") has estimated that the demand for freight transportation will increase by 55 percent between 1998 and 2020.[1] More recently, DOT projected that total freight transportation demand will rise 92 percent from 2002 to 2035, including an 88 percent increase for railroads.[2] Similarly, the American Association of State Highway and Transportation Officials projected that freight tonnage will grow by almost 57 percent between 2000 and 2020. Whether 88 percent, 55 percent, 57 percent, or some other percent is the exact right estimate is not what is important. What is important is that demand has been growing and is expected to continue to grow substantially. And if this substantial growth in demand occurs, it is very likely that railroads will need to go into the equity market to obtain the large sums necessary to finance the capacity needed to meet the increased demand.[3]

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1 U.S. DOT, Federal Highway Administration, *Freight Analysis Framework*, October 2002.

2 Federal Highway Administration, *Freight Facts and Figures 2006*, Table 2.1.

3 Railroads will be critical to meet this growing demand for freight transportation because highways will be unable to absorb that kind of growth in demand for freight transportation. Highways are already choked; and highway capacity is not likely to expand to any significant degree. AASHTO, *Freight Rail Bottom-Line Report*, at 2; *see also* Testimony of Jeffrey N. Shane, Under Secretary of Transportation For Policy, at April 11, 2007, hearing in Ex Parte No. 671, *Rail Capacity and Infrastructure Requirements* (noting that there will not be a second "Eisenhower highway plan"); Statement of Jeffrey N. Shane Before the Committee on Transportation and Infrastructure, Subcommittee on Highways and Transit, U.S. House of Representatives, Jan. 24, 2007 (available at http://testimony.ost.dot.gov/test/shane1.htm) ("How will our transportation system handle these demands? We certainly do not plan to more than

There is no disputing the fact that increasing railroad capacity is expensive. U.S. freight railroads have been devoting enormous resources to maintain their existing infrastructure, to improve their operations and infrastructure, and to alleviate the capacity constraints that arise from increasing freight demand. Indeed, from 1996 to 2005, while the average U.S. manufacturer spent 3.4 percent of revenue on capital spending, freight railroads spent 17.2 percent, or more than five times more. Every dollar railroads invest in additional capacity is 100 percent at risk. Unlike utilities, there is no guaranteed return on existing assets, much less on assets under construction.[4] Because there is no guaranteed return, at Norfolk Southern the bar to determine whether to invest in additional capacity or infrastructure is higher than our internal cost of capital calculation.

Although more investment and expansion will be needed,[5] it is quite possible that railroads will not be able to fund the expansion necessary to maintain rail's market share without recourse to external capital. Cambridge Systematics, Inc., recently completed a study to determine the amount of investment that would be required over the next 28

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double the number of lanes-miles of highways. Lane-miles of highways have increased by only 5.3 percent over the past 24 years, and an extrapolation to 2050 suggests that highway capacity will only increase by 10 percent by that year").

4 For example, Wisconsin Power and Light recently sought authority to construct, own, and operate a wind farm. In approving the project, the Public Service Commission of Wisconsin authorized a return on equity of 10.5 percent for the 20-year life span of the project. Application of Wisconsin Power and Light Company for a Certificate of Authority to Construct and Operate a Wind Electric Generation Facility Known as Cedar Ridge Wind Farm in Fond du Lac County, and an Application for Approval of Fixed Financial *Parameters and Capital Cost Rate-Making Principles for the Cedar Ridge Wind Farm Project*, filed May 10, 2007, in Public Service Commission of Wisconsin, Docket No. 6680-CE-171, at 5. When railroads invest in new infrastructure they are not guaranteed any return on their investment. The railroads' investments are 100 percent at risk.

5 See Ex Parte 664, Methodology to Be Employed in Determining the Railroad Industry's Cost of Capital, Reply Comments of the U.S. Department at of Transportation, at 7 ("Reply Comments of U.S. DOT").

years for railroads to meet the U.S. Department of Transportation's ("U.S. DOT") forecast of growth in freight demand.[6] It assumes that rail's market share will remain unchanged over that time period. Of the $148 billion that the study estimates will be required over the next 28 years to keep pace with the economic growth and meet the U.S. DOT's forecasted demand, Class I freight railroads' share is projected to be $135 billion.[7]

The report concludes that the Class I railroads will not be able to generate all of the $135 billion through increased earnings from revenue growth, higher volumes, and productivity improvements, while continuing to renew existing infrastructure and equipment. A balance of $39 billion, or about $1.4 billion per year, would be left for the Class I freight railroads to fund "from railroad investment tax incentives, public-private partnerships, or other sources."[8] Those other sources would include borrowing and equity issuances, both of which would be adversely affected by a regulatory cost of capital that is too low.

With the projected large increases in freight demand and the nation already on the brink of a transportation crisis, one or more railroads may need to seek an infusion of cash by issuing additional equity to invest in needed capacity. If and when railroads seek that additional capital, it is critical that the market view railroads as a favorably investment.

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6 National Rail Freight Infrastructure Capacity and Investment Study, by Cambridge Systematics, at ES-1 (September 2007) ("National Rail Freight Study").

7 National Rail Freight Study, at ES-1. The study's estimate is conservative because it excludes costs associated with expansion other than capital costs.

8 National Rail Freight Study, at 7-6.

II. A LOW COST OF CAPITAL HURTS THE RAILROAD INDUSTRY'S ABILITY TO ATTRACT AND RETAIN CAPITAL.

The only sources of money for railroads to fund the expansion that will likely be required in the future are (1) revenues from customers; (2) debt; (3) equity; and (4) public money. But, a lower cost of capital adversely affects each of the first three. Accordingly, if railroads are to expand their infrastructure, a low cost of capital will placc a grcater burden on the already cash-strapped federal government to make it happen. The better public policy is to continue to encourage private sector investment by setting a reasonable cost of capital.

A lower cost of capital adversely affects three of the four potential sources of money that are available to railroads. First, a lower cost of capital could result in additional restraints on railroad ratemaking. These constraints would reduce the revenues available to the railroad from certain customers. Thus, the amount of money available within a railroad to invest would also be constrained.

Second, a lower cost of capital will result in a higher cost of borrowing because of the perceived increased risk associated with a railroad. Money would likely still be available to railroads but at less favorable terms. Those less favorable terms will mean that railroads can borrow less than they could at more favorable terms.

Third, a lower cost of capital will result in railroads raising less money in the equity markets. Railroads have not been in the equity market in a long time, but if the large traffic increases materialize, selling equity is a likely source of capacity funding. An artifically low cost of capital would undercut the efforts that railroads, like other companies, take to make their companies attractive enough to attract and retain investor interest. If regulators say that railroads should earn only eight percent, then railroads will not generate as much money for each share of new stock they issue.

With a lower cost of equity, public funding would have to assume a larger role or much expansion of rail capacity will not occur. Of course, where the government would find that substantial a sum of money is questionable, especially in light of the limited number of dollars in the Federal discretionary budget.

In some ways, railroads are similarly positioned to some of Western Coal Traffic League's ("WCTL") members. Rocky Mountain Power, whose parent PacifiCorp is a member of WCTL, understands the need to have earnings sufficient to attract equity from investors. Donald N. Furman, its Senior Vice President, Regulation and External Affairs, recently testified that his company "now needs additional revenue to maintain and expand critical infrastructure, continue reliable service to customers, and ensure access to needed equity on reasonable terms. It is clear that PacifiCorp is in a growth cycle and needs to be in a position to attract equity from investors."[9]

It appears from WCTL's positions in this proceeding that what is good for the utility goose is not good for the railroad gander. But Mr. Furman's rationale accurately describes the current state of the railroad industry and why the Board must remain focused on how its actions will affect the railroad industry's ability to attract and retain capital. The Board's cost of capital should be on the high side to maximize the likelihood of private sector solutions to the growing transportation and infrastructure crisis.

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9 Application of Utah Power & Light Company, filed in the Public Service Commission of Utah Docket No. 0403542, Direct Testimony of Donald N. Furman, at 3. Mr. Furman made this point in arguing for rate increases to bring returns up to its cost of equity, and his company's expert submitted multiple methodologies for calculating the cost of equity, including a DCF model and a CAPM model.

III. THE RISKS OF UNDERSTATING THE COST OF CAPITAL FAR OUTWEIGHT THE RISKS OF OVERSTATING IT.

Several facts are undisputed in this proceeding:

- First, the cost of equity is not directly observable in the marketplace and any regulatory calculation is an approximation;
- Second, the railroad industry must make massive investments in additional network infrastructure to meet expected growth in demand in the next three decades;
- Third, Congress required the Board to permit railroads to earn revenues that are adequate to attract and retain needed investment capital;[10]
- Fourth, railroads – or any regulated business for that matter – cannot attract and retain sufficient capital when their regulator establishes an artificially low cost of capital, which signals to markets that returns on investments may be restricted in various ways; and
- Fifth, the potential harms to rail customers, consumers, and the United States economy are great if the railroads are prevented by regulation from recovering their actual cost of capital.

When the Board adopts the industry's cost of capital, the public policy question is whether it is riskier for the Board to err on the side of overstating or on the side of understating a regulatory estimate of the cost of capital.

The risk of overstating the railroads' regulatory cost of capital is that the railroads may be somewhat healthier and railroad investors will have excess returns and attract more capital to the industry. As a result, healthier more attractive railroads may be able to justify additional investment in infrastructure projects sooner.

The risk of understating the railroads' cost of capital is that the railroads will not be able to attract and retain the capital they will need to meet the growing demand for freight transportation and that rail customers, consumers, and the United States economy

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10 49 U.S.C. 10101(3)-(4).

will suffer. Moreover, an artificially low cost of capital could result in shrinkage of rail infrastructure and deterioration of capacity should the market perceive that the regulatory cost of capital is the maximum return a railroad can earn over some long period of time.[11]

Accordingly, the market would likely make demands on the railroads. First, the market would discourage railroads from investing in their systems when below market returns (at best) would be expected. As a utility's witness recently testified, "[e]quity investors expect a return on their capital commensurate with the risks they take and consistent with returns that might be available from other similar investments."[12] Second, if the market cannot have a reasonable expectation that capital reinvested in the railroad will earn at least a market return, then the market acting through shareholders will insist that capital be returned to the them so that they can invest it elsewhere and earn market returns that are not artificially capped. Third, the market could demand that railroads take both of these actions

Norfolk Southern respectfully submits that in these times of constrained transportation capacity, it would be irresponsible public policy to err on the side of understating the railroads' regulatory cost of capital. The risks are simply too great.

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11 See Comments of The Children's Investment Fund, at 4 ("As an investor we are deeply concerned that the Board may be pressured to change the rate case methodology away from stand-alone costs (after finding railroads to be revenue adequate) to in effect cap revenues at levels required to be revenue adequate.").

12 In the Matter of the Application of Rocky Mountain Power for Approval of Changes to Its Electric Service Schedules, filed June 8, 2007, in Idaho Public Utilities Commission Case No. PAC-E-07-05, Direct Testimony of Samuel C. Hadaway, at 5 ("Direct Testimony of Samuel C. Hadaway").

IV. THE BOARD SHOULD NOT JETTISON ITS LONG-TENURED DCF MODEL AND SHOULD AVOID UNREALISTIC INPUTS FOR THE MULTIPLE SUBJECTIVE ELEMENTS OF CAPM.

A. DCF Remains Widely Used and a Reasonable Methodology.

Although this hearing is about the Board's proposal to move to CAPM for regulatory purposes and about the Board's proposed method for implementing CAPM, NS believes DCF should not be written off by the Board. NS uses the DCF model, along with a CAPM model, internally, and DCF is used in many regulatory forums. Retaining the DCF would be a reasonable choice, and the Board should reconsider its decision to abandon it.

Any thought that DCF generally is dead is incorrect. Pennsylvania has a stated preference for DCF.[13] And the Federal Energy Regulatory Commission uses a DCF model.[14]

Some of the pleadings in this matter are ironic because the railroads' utility customers seem to argue that DCF is no longer an appropriate tool for calculating the railroads' cost of equity despite their own use of DCF in their own regulatory proceedings. For example, just this year, Rocky Mountain Power sought approval from

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[13] Office of Small Business Advocate, Office of Consumer Advocate, Mary Kay Gummo, Michael Blake v.PPL Gas Utilities Corporation, in Pennsylvania Public Utility Commission, Office, Docket No. R-00061398; R-00061398C0001; R-00061398C0002; R-00061398C0003; R-00061398C0004 2007 Pa. PUC LEXIS 2, at *167-171 (February 8, 2007). Only in a recent decision has the Pennsylvania Public Utility Commission even used other models as a check on its preferred DCF. Id.

[14] Cost-of-Service Rates Manual, Federal Energy Regulatory Commission, at 16 (June 1999) (explaining FERC's use of a two-stage DCF). In July 2007, the Federal Energy Regulatory Commission reaffirmed its use of a DCF, although it considered whether to expand the appropriate proxy group. Commission Proposes to Modify Rate of Return Standards For Interstate Gas, Oil Pipeline Companies, Federal Energy Regulatory Commission press release (July 19, 2007), available at http://www.ferc.gov/news/news-releases/2007/2007-3/07-19-07-G-1.pdf.

the Idaho Public Utilities Commission to change its rate schedules for electric service. Its expert testified as follows: "the DCF model has a sound basis in theory, and many argue that it has the additional advantage of simplicity."[15] Similarly, Wisconsin Power and Light's expert in a recent regulatory proceeding before the Public Service Commission of Wisconsin noted that the DCF model "is widely used in valuing entire companies."[16] It seems the DCF only lacks value for railroads – but not for WCTL's members.

The Board in its Notice of Proposed Rulemaking had one rationale for rejecting its long-used DCF model. The Board noted that the DCF was easy to use because most of the inputs were readily available, but expressed concern about the only variable that had any element of subjectivity – the long term growth rate.[17] Estimating the DCF input of long-term growth can be tricky at times. But as Rocky Mountain Power's expert noted, "[w]hile the caveat about estimating long-term growth must be observed, the DCF model's other inputs are readily obtainable, and the model's results typically are consistent with capital market behavior."[18] That one variable was somewhat subjective was no reason to jettison DCF.

Because DCF is widely used, including by WCTL's members in their own regulatory proceedings, the Board should reconsider its proposed abandonment of its long-tenured DCF model. The Board especially should reconsider its rationale for

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15 Direct Testimony of Samuel C. Hadaway, at 12.

16 Application of Wisconsin Power and Light Company, filed September 13, 2006, in Public Service Commission of Wisconsin Docket No. 6680-CE-171, Pre-Filed Direct Testimony of James M. Coyne, at 7 (using both DCF and CAPM to determine cost of equity).

17 Ex Pate 664, Methodology to Be Employed in Determining the Railroad Industry's Cost of Capital, Notice, at 4 (served August 14, 2007).

18 Direct Testimony of Samuel C. Hadaway, at 12.

abandoning DCF, because a methodology with only one subjective input is far better for regulatory purposes than exclusive reliance on the CAPM methodology, which has three subjective inputs – the market risk premium, the risk free rate, and the beta.

B. Use of Several Approaches To Estimate the Cost of Equity May Be Appropriate.

Even if the Board continues to pursue alternatives to DCF, it should not abandon DCF altogether. Many state regulatory agencies use other methodologies either as a reality check on a DCF model or in conjunction with a DCF model. Internally, NS uses both DCF and CAPM to evaluate its own cost of equity.

There are good reasons to use both methodologies. As an expert witness for North States Power Company, whose parent is Xcel Energy and a member of WCTL, recently testified before the Public Service Commission of Wisconsin:

> The cost of equity is not directly observable in the marketplace. Therefore, to estimate the cost of equity, one must take cognizance of financial theory, the legal and regulatory framework for ratemaking and investor perceptions and judgments. There is no one approach that is now recognized, or should be recognized, as the best way to determine the cost of equity.[19]

The expert then submitted calculations from both DCF and CAPM.

Indeed, many state regulatory commissions use both DCF and CAPM (as well as other methodologies) in determining the cost of equity. Based on a quick look, it appears that a sample of states that use at least DCF and CAPM would include Georgia, Kentucky, Kansas, North Carolina, South Carolina, and Texas.

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[19] Application of Northern States Power Company, a Wisconsin Corporation and Wholly Owned Subsidiary of Xcel Energy, Inc., for Authority to Adjust Electric and Natural Gas Rates, filed June 1, 2007, in Public Service Commission of Wisconsin Docket No. 4220-UR-115, Direct Testimony of Zvi Benderly, at 2-3.

C. CAPM May Also Be a Reasonable Approach, But Care Is Required Because It Has Inputs That Require Subjective Determinations.

CAPM, properly applied, may also be a reasonable choice. The Board should not ignore the fact that CAPM has many inputs that require substantial subjective determinations. Whereas the DCF has one input that is difficult to determine, CAPM has three inputs that are difficult to determine.

Indeed, because elements of CAPM are so subjective, some utilities have argued that CAPM is inappropriate for regulatory purposes. South Carolina Electric and Gas Company's ("SCE&G") expert witness, in a 2002 regulatory proceeding, relied exclusively on DCF. He "rejected the capital asset pricing model because it is not a reliable and useful analytical tool for estimating SCE&G's cost of equity capital." In particular, he concluded that in each analysis performed using CAPM, "the results are unreliable and grossly understate the required rate of return for SCE&G."[20] Relying on this and other testimony. the Public Service Commission of South Carolina rejected all CAPM models submitted to it because "reasonable expectations of returns in the markets are indeed greater than those indicated in the CAPM model."[21] The concern SCG&E's

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[20] Application of South Carolina Electric and Gas Company for Approval of an Increase in Its Electric Rates and Charges, filed November 12, 2002, in Public Service Commission of South Carolina Docket No. 2002-223-E, Rebuttal Testimony of Burton G. Malkiel, at 5.

[21] Application of South Carolina Electric and Gas Company for Approval of an Increase in Its Electric Rates and Charges, filed November 12, 2002, in Public Service Commission of South Carolina Docket No. 2002-223-E, Order No. 2003-38, at 55 (Jan. 31, 2003) ("The Commission finds that the results of the CAPM model, when measured against present economic conditions and investor's expectations, does not produce credible results."). The Commission held that it was "convinced that the most prudent, just and reasonable response to the financial evidence, to present business conditions, and to the interrelated interests of the Company and its customers, is to set a rate of return for the utility at the high end of the return-on-equity range." Id. at 70.

expert expressed is the same concern that Norfolk Southern, the AAR, and other railroads have made in this proceeding. CAPM, as the Board proposes to implement it, understates the cost of equity.

Norfolk Southern is concerned that the Board has chosen inputs for its CAPM that are unrealistic – the market risk premium, risk free rate, and beta are all low. NS incorporates here by reference the criticisms of the Board's proposed implementation of CAPM that have been submitted in this proceeding by the Association of American Railroad. Indeed, many of the criticisms leveled against the Board's implementation of CAPM have been made in state regulatory proceedings – by members of WCTL.[22]

The bottom line is that the results of the various available methodologies – CAPM, DCF, the Ohlson-Juetter model, and other models, properly applied -- should produce results that fall within a relatively narrow range.[23] In light of the round criticisms of CAPM's use for regulatory purposes by some utilities in their own proceedings and the criticisms of CAPM as proposed by the Board, the Board at a minimum must reconsider its proposed CAPM methodology.

V. CONCLUSION

Whichever methodology or methodologies the Board decides to use, it must generate a realistic estimate of the cost of capital. In the current environment in which freight capacity is already constrained and forecasts are for further growth in freight demand for years to come, the Board should be extremely cautious not to underestimate

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22 See Ex Parte 664, Methodology to Be Employed in Determining the Railroad Industry's Cost of Capital, Reply Comments of the Association of American Railroads, at 6-8 (filed October 29, 2007).

23 See Reply Comments of the U.S. DOT, at 2.

the industry's cost of capital. The risks of such an understatement are that railroads will not have access to the capital that will be required to increase capacity. And a rail system with inadequate capacity is not in the interest of anyone – not the railroads, not rail customers, and not taxpayers.

Respectfully Submitted,

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Dated: November 27, 2007

Eastern Carriers Agriculture Traffic Volume and Market Share

	NS						CSX					
	Volume (000)			Market Share			Volume (000)			Market Share		
	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change
2000 Q1	99.9	82.8	20.7%	45.7%	35.3%	10.4	115.8	89.9	28.8%	53.0%	38.3%	14.6
2000 Q2	101.4	89.6	13.2%	47.2%	40.6%	6.7	110.5	91.5	20.9%	51.5%	41.4%	10.1
2000 Q3	103.6	101.6	2.0%	47.6%	48.0%	(0.3)	111.2	107.4	3.6%	51.1%	50.7%	0.5
2000 Q4	106.7	101.3	5.3%	46.3%	45.8%	0.5	121.3	116.9	3.7%	52.6%	52.9%	(0.3)
2001 Q1	104.6	99.8	4.8%	45.1%	45.7%	(0.6)	124.8	115.8	7.8%	53.8%	53.0%	0.8
2001 Q2	104.6	101.4	3.1%	46.4%	47.2%	(0.8)	118.0	110.5	6.8%	52.4%	51.5%	1.0
2001 Q3	100.7	103.9	(3.1%)	46.5%	47.7%	(1.2)	113.0	111.2	1.6%	52.2%	51.1%	1.1
2001 Q4	110.6	106.5	3.8%	48.0%	46.2%	1.8	116.4	121.3	(4.0%)	50.6%	52.6%	(2.0)
2002 Q1	104.1	104.9	(0.8%)	46.5%	45.1%	1.4	116.1	124.8	(7.0%)	51.9%	53.7%	(1.8)
2002 Q2	103.3	104.9	(1.5%)	47.2%	46.5%	0.7	111.9	118.0	(5.2%)	51.1%	52.4%	(1.2)
2002 Q3	103.8	100.3	3.5%	47.7%	46.4%	1.3	110.2	113.0	(2.5%)	50.7%	52.3%	(1.6)
2002 Q4	108.8	110.4	(1.5%)	47.1%	48.0%	(1.0)	118.3	116.4	1.7%	51.2%	50.6%	0.6
2003 Q1	104.7	104.2	0.5%	46.8%	46.5%	0.3	115.3	116.1	(0.6%)	51.5%	51.9%	(0.3)
2003 Q2	105.4	103.5	1.9%	47.2%	47.3%	(0.0)	113.9	111.9	1.8%	51.0%	51.1%	(0.1)
2003 Q3	106.4	103.8	2.5%	47.9%	47.7%	0.2	112.1	110.2	1.7%	50.5%	50.7%	(0.2)
2003 Q4	112.8	108.6	3.9%	47.7%	47.0%	0.7	120.0	118.3	1.4%	50.7%	51.2%	(0.5)
2004 Q1	108.0	106.5	1.4%	47.5%	46.9%	0.7	115.8	116.9	(1.0%)	50.9%	51.4%	(0.5)
2004 Q2	104.5	105.1	(0.6%)	47.7%	47.3%	0.4	111.3	113.5	(2.0%)	50.7%	51.0%	(0.3)
2004 Q3	106.7	106.4	0.3%	49.4%	47.9%	1.5	105.9	112.3	(5.7%)	49.0%	50.5%	(1.5)
2004 Q4	111.0	111.8	(0.6%)	49.2%	47.6%	1.6	110.6	119.4	(7.3%)	49.0%	50.8%	(1.8)
2005 Q1	110.4	108.4	1.9%	48.1%	47.6%	0.5	115.0	115.8	(0.7%)	50.1%	50.9%	(0.8)
2005 Q2	109.1	104.6	4.2%	48.6%	47.7%	0.9	111.3	111.3	0.1%	49.6%	50.7%	(1.1)
2005 Q3	104.5	106.5	(1.8%)	47.7%	49.3%	(1.6)	110.9	105.9	4.7%	50.6%	49.1%	1.5
2005 Q4	108.0	111.7	(3.4%)	47.5%	49.3%	(1.8)	115.0	110.6	4.0%	50.7%	48.9%	1.8
2006 Q1	107.6	110.6	(2.7%)	47.1%	48.4%	(1.4)	116.8	113.7	2.8%	51.1%	49.8%	1.3

Source: Data Compiled by the Association of American Railroads

Exhibit B

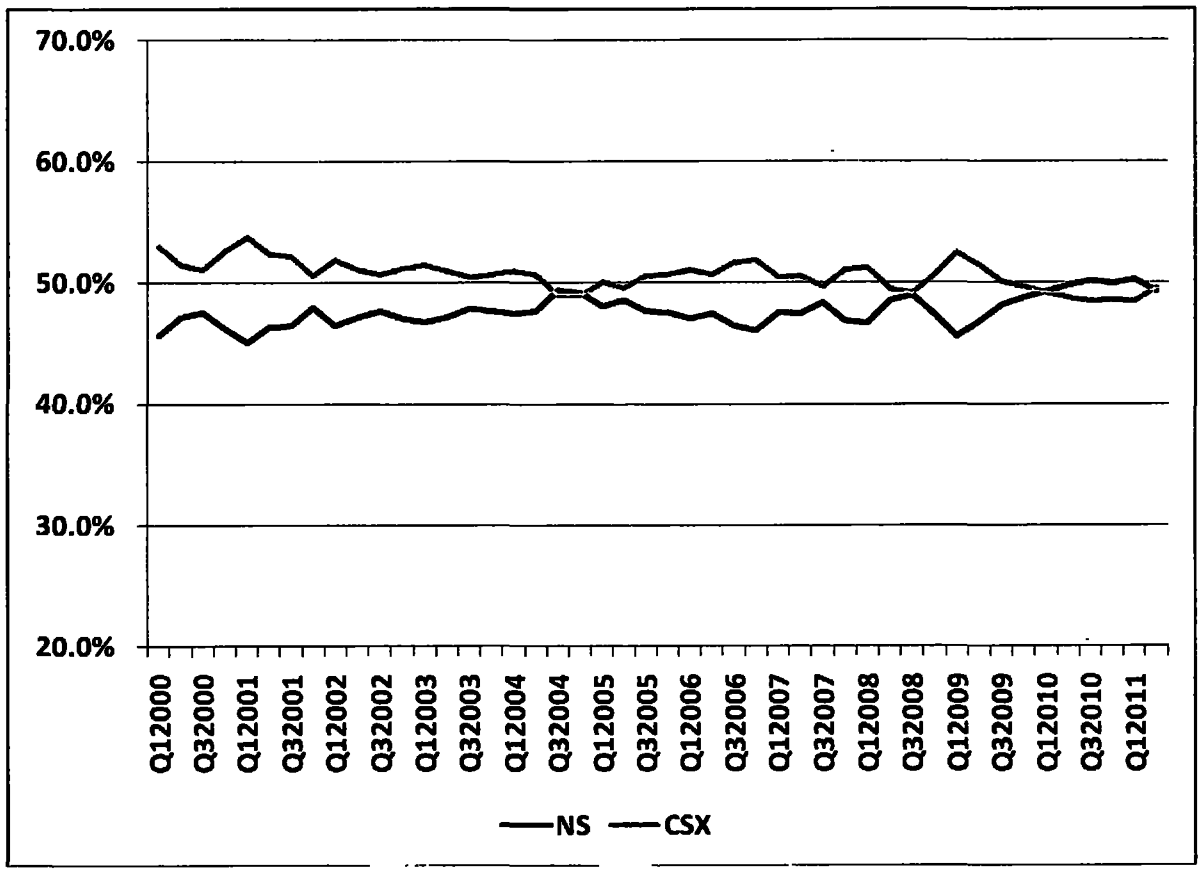
Eastern Carriers Agriculture Traffic Volume and Market Share

	NS						CSX					
	Volume (000)			Market Share			Volume (000)			Market Share		
	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change
2006 Q2	107.5	109.1	(1.5%)	47.5%	48.9%	(1.4)	114.8	109.7	4.6%	50.7%	49.2%	1.5
2006 Q3	108.0	104.5	3.3%	46.5%	48.1%	(1.6)	120.1	109.0	10.2%	51.7%	50.2%	1.5
2006 Q4	108.8	108.1	0.7%	46.1%	47.9%	(1.7)	122.4	113.7	7.7%	51.9%	50.3%	1.5
2007 Q1	104.5	107.5	(2.9%)	47.6%	47.0%	0.5	110.8	116.8	(5.1%)	50.5%	51.1%	(0.6)
2007 Q2	108.7	107.6	1.0%	47.5%	47.5%	0.0	115.7	114.8	0.8%	50.6%	50.7%	(0.1)
2007 Q3	109.5	107.8	1.6%	48.4%	46.4%	1.9	112.6	120.1	(6.3%)	49.7%	51.7%	(2.0)
2007 Q4	110.1	108.8	1.2%	46.9%	46.1%	0.7	120.0	122.4	(1.9%)	51.1%	51.9%	(0.8)
2008 Q1	105.5	104.5	0.9%	46.7%	47.6%	(0.9)	115.9	110.8	4.6%	51.3%	50.5%	0.8
2008 Q2	112.4	108.6	3.5%	48.6%	47.5%	1.1	114.4	115.7	(1.1%)	49.5%	50.6%	(1.2)
2008 Q3	109.0	109.3	(0.4%)	49.0%	48.3%	0.7	109.5	112.6	(2.8%)	49.2%	49.8%	(0.5)
2008 Q4	111.2	117.1	(5.0%)	47.4%	46.7%	0.7	119.2	128.6	(7.3%)	50.7%	51.3%	(0.5)
2009 Q1	96.2	107.8	(10.8%)	45.6%	47.1%	(1.4)	110.7	116.8	(5.3%)	52.5%	51.0%	1.5
2009 Q2	97.8	111.8	(12.5%)	46.8%	48.7%	(1.9)	107.5	113.6	(5.4%)	51.5%	49.5%	1.9
2009 Q3	95.3	109.1	(12.7%)	48.2%	49.1%	(0.9)	99.0	109.8	(9.8%)	50.1%	49.4%	0.7
2009 Q4	107.2	102.8	4.3%	48.8%	47.4%	1.3	109.3	110.2	(0.8%)	49.7%	50.8%	(1.1)
2010 Q1	112.8	96.2	17.3%	49.3%	45.7%	3.6	112.6	110.7	1.8%	49.2%	52.6%	(3.4)
2010 Q2	106.4	97.8	8.8%	49.8%	46.8%	3.0	104.2	107.5	(3.1%)	48.8%	51.5%	(2.7)
2010 Q3	107.6	95.5	12.7%	50.2%	48.2%	1.9	103.9	99.0	4.9%	48.5%	50.0%	(1.6)
2010 Q4	112.2	107.1	4.8%	50.0%	48.7%	1.3	109.1	109.3	(0.1%)	48.6%	49.7%	(1.1)
2011 Q1	109.6	112.7	(2.8%)	50.3%	49.3%	1.0	105.6	112.7	(6.3%)	48.5%	49.2%	(0.8)
2011 Q2	108.8	106.4	2.2%	49.3%	49.8%	(0.5)	109.3	104.2	4.8%	49.6%	48.8%	0.8

Source: Data Compiled by the Association of American Railroads

Exhibit B

Eastern Carriers Agriculture Market Share



Source: Data Compiled by the Association of American Railroads

Exhibit B

Eastern Carriers Coal Traffic Volume and Market Share

	NS						CSX					
	Volume (000)			Market Share			Volume (000)			Market Share		
	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change
2000 Q1	427.7	309.6	38.2%	45.6%	31.8%	13.8	433.6	404.8	7.1%	46.3%	41.6%	4.7
2000 Q2	439.9	344.1	27.9%	45.5%	35.3%	10.1	449.6	429.8	4.6%	46.4%	44.2%	2.3
2000 Q3	423.6	436.6	(3.0%)	43.5%	43.6%	(0.1)	475.8	477.6	(0.4%)	48.9%	47.7%	1.2
2000 Q4	406.6	431.8	(5.8%)	43.3%	44.7%	(1.4)	460.5	451.1	2.1%	49.1%	46.7%	2.3
2001 Q1	444.4	428.7	3.7%	44.7%	45.7%	(1.0)	471.6	433.6	8.8%	47.4%	46.2%	1.2
2001 Q2	440.0	439.3	0.2%	44.6%	45.4%	(0.8)	470.9	449.6	4.7%	47.7%	46.5%	1.2
2001 Q3	403.2	423.9	(4.9%)	43.2%	43.5%	(0.4)	458.8	475.8	(3.6%)	49.1%	48.9%	0.2
2001 Q4	416.1	405.7	2.6%	43.9%	43.3%	0.7	460.0	460.5	(0.1%)	48.6%	49.1%	(0.5)
2002 Q1	407.4	449.1	(9.3%)	45.4%	45.0%	0.5	419.0	471.6	(11.2%)	46.7%	47.2%	(0.5)
2002 Q2	395.0	440.2	(10.3%)	43.5%	44.6%	(1.1)	421.9	470.9	(10.4%)	46.5%	47.7%	(1.2)
2002 Q3	409.0	402.5	1.6%	44.3%	43.1%	1.1	430.2	458.8	(6.2%)	46.6%	49.2%	(2.6)
2002 Q4	403.9	416.2	(3.0%)	44.1%	43.9%	0.2	427.7	460.0	(7.0%)	46.7%	48.6%	(1.9)
2003 Q1	403.1	407.9	(1.2%)	45.6%	45.5%	0.2	399.5	419.0	(4.7%)	45.2%	46.7%	(1.5)
2003 Q2	424.8	394.9	7.5%	44.7%	43.5%	1.2	432.5	421.9	2.5%	45.5%	46.5%	(1.0)
2003 Q3	402.7	408.9	(1.5%)	43.9%	44.3%	(0.4)	424.4	430.2	(1.3%)	46.2%	46.6%	(0.3)
2003 Q4	390.1	404.6	(3.6%)	42.6%	44.2%	(1.5)	441.0	427.7	3.1%	48.2%	46.7%	1.5
2004 Q1	415.0	409.5	1.3%	43.9%	45.7%	(1.8)	439.3	404.1	8.7%	46.4%	45.1%	1.4
2004 Q2	431.3	411.7	4.8%	44.8%	44.5%	0.3	437.0	423.3	3.3%	45.3%	45.7%	(0.4)
2004 Q3	427.1	415.2	2.9%	44.4%	44.1%	0.3	442.5	436.3	1.4%	45.9%	46.3%	(0.4)
2004 Q4	425.5	382.8	11.2%	44.2%	42.2%	1.9	441.7	438.8	0.7%	45.9%	48.4%	(2.6)
2005 Q1	431.0	414.2	4.1%	42.3%	43.8%	(1.5)	477.6	439.3	8.7%	46.9%	46.5%	0.4
2005 Q2	439.8	431.4	1.9%	44.0%	45.8%	(1.8)	480.3	437.0	9.9%	48.0%	46.4%	1.7
2005 Q3	450.8	427.0	5.6%	45.7%	45.3%	0.4	459.3	442.5	3.8%	46.6%	46.9%	(0.4)
2005 Q4	422.1	428.9	(1.6%)	44.0%	45.3%	(1.3)	468.1	441.7	6.0%	48.8%	46.6%	2.1
2006 Q1	443.0	432.0	2.5%	44.0%	43.5%	0.5	486.1	469.0	3.7%	48.3%	47.3%	1.1

Source: Data Compiled by the Association of American Railroads

Exhibit B

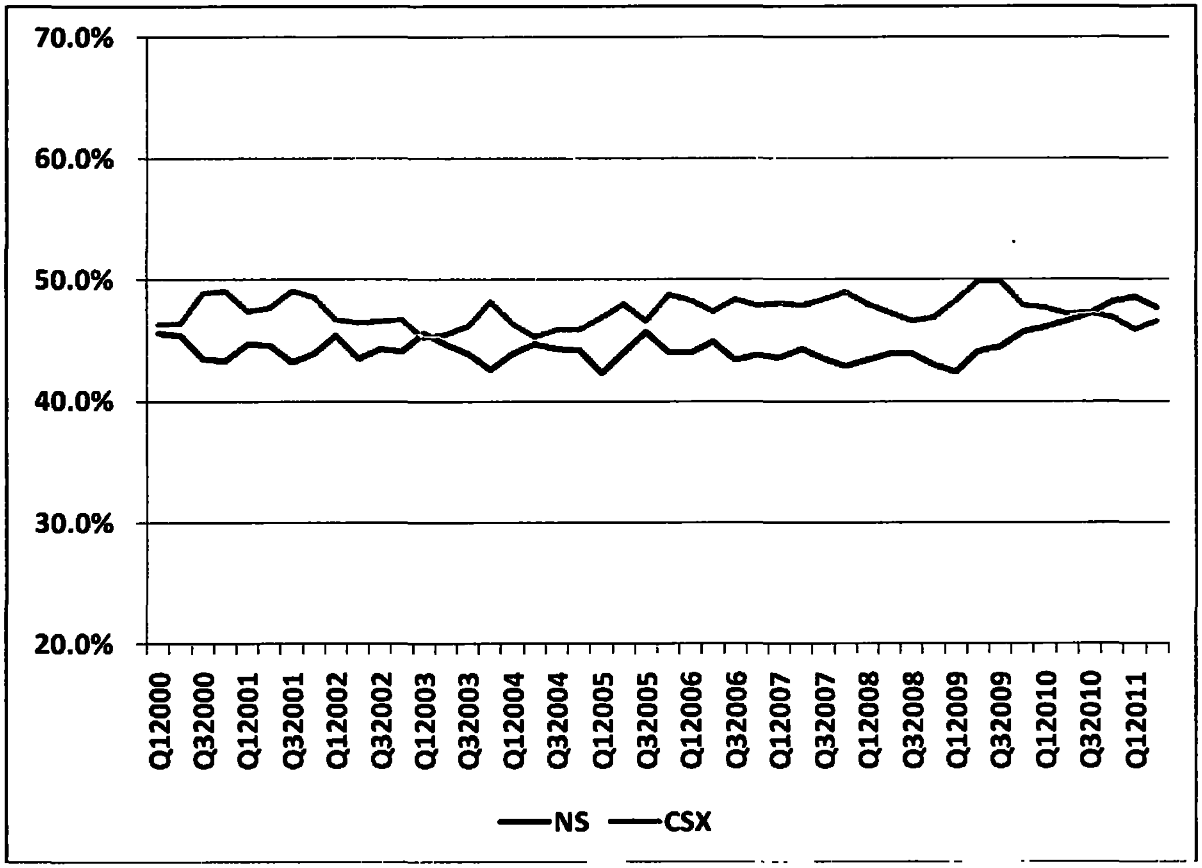
Eastern Carriers Coal Traffic Volume and Market Share

	NS						CSX					
	Volume (000)			Market Share			Volume (000)			Market Share		
	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change
2006 Q2	452.2	442.4	2.2%	44.9%	44.5%	0.4	477.7	471.2	1.4%	47.4%	47.4%	0.0
2006 Q3	435.6	451.1	(3.4%)	43.4%	46.1%	(2.7)	485.8	452.3	7.4%	48.4%	46.2%	2.2
2006 Q4	438.1	422.5	3.7%	43.8%	44.4%	(0.6)	479.6	459.5	4.4%	48.0%	48.3%	(0.4)
2007 Q1	427.7	442.8	(3.4%)	43.6%	44.0%	(0.4)	471.7	486.1	(3.0%)	48.1%	48.3%	(0.2)
2007 Q2	437.4	452.3	(3.3%)	44.3%	44.9%	(0.6)	472.7	477.7	(1.0%)	47.9%	47.4%	0.5
2007 Q3	427.4	433.5	(1.4%)	43.5%	43.2%	0.2	475.3	485.8	(2.2%)	48.4%	48.5%	(0.1)
2007 Q4	417.4	438.6	(4.8%)	42.9%	43.8%	(0.9)	477.0	479.6	(0.5%)	49.0%	47.9%	1.1
2008 Q1	428.0	427.7	0.1%	43.4%	43.6%	(0.2)	473.6	471.7	0.4%	48.0%	48.1%	(0.1)
2008 Q2	452.1	437.8	3.3%	43.9%	44.3%	(0.4)	486.8	472.7	3.0%	47.3%	47.9%	(0.6)
2008 Q3	447.4	427.3	4.7%	43.9%	43.5%	0.4	475.5	475.3	0.0%	46.6%	48.4%	(1.7)
2008 Q4	464.5	441.4	5.2%	43.0%	42.7%	0.3	507.1	507.7	(0.1%)	46.9%	49.2%	(2.2)
2009 Q1	392.1	439.8	(10.8%)	42.4%	43.7%	(1.2)	446.0	481.8	(7.4%)	48.3%	47.8%	0.5
2009 Q2	327.5	443.2	(26.1%)	44.1%	45.5%	(1.5)	370.7	475.7	(22.1%)	49.9%	48.9%	1.0
2009 Q3	352.3	455.9	(22.7%)	44.5%	45.3%	(0.9)	395.5	488.2	(19.0%)	49.9%	48.5%	1.4
2009 Q4	348.0	430.4	(19.1%)	45.7%	44.9%	0.8	365.2	466.6	(21.7%)	47.9%	48.7%	(0.8)
2010 Q1	377.1	392.8	(4.0%)	46.1%	44.0%	2.1	389.8	446.0	(12.6%)	47.7%	50.0%	(2.3)
2010 Q2	397.0	328.4	20.9%	46.6%	44.2%	2.4	402.3	370.7	8.5%	47.2%	49.8%	(2.6)
2010 Q3	401.2	353.2	13.6%	47.2%	44.5%	2.6	402.0	395.5	1.6%	47.3%	49.9%	(2.6)
2010 Q4	393.5	347.8	13.1%	48.2%	45.7%	2.6	382.5	365.2	4.7%	46.9%	48.0%	(1.1)
2011 Q1	415.1	377.5	9.9%	48.6%	46.1%	2.5	392.1	389.9	0.6%	45.9%	47.6%	(1.7)
2011 Q2	404.2	396.7	1.9%	47.7%	46.6%	1.2	394.3	401.9	(1.9%)	46.6%	47.2%	(0.6)

Source: Data Compiled by the Association of American Railroads

Exhibit B

Eastern Carriers Coal Market Share



Source: Data Compiled by the Association of American Railroads

Exhibit B

Eastern Carriers Total Traffic Volume and Market Share

	NS						CSX					
	Volume (000)			Market Share			Volume (000)			Market Share		
	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change
2000 Q1	1690.0	1190.3	42.0%	44.9%	30.3%	14.6	1845.1	1397.6	32.0%	49.0%	35.6%	13.4
2000 Q2	1756.4	1382.2	27.1%	45.7%	35.4%	10.3	1844.4	1557.3	18.4%	48.0%	39.9%	8.1
2000 Q3	1716.4	1696.3	1.2%	45.7%	44.9%	0.8	1804.5	1827.4	(1.3%)	48.1%	48.4%	(0.3)
2000 Q4	1675.1	1675.3	(0.0%)	45.6%	44.7%	0.9	1777.7	1828.2	(2.8%)	48.4%	48.8%	(0.4)
2001 Q1	1660.9	1691.1	(1.8%)	45.6%	44.9%	0.7	1760.6	1845.1	(4.6%)	48.3%	49.0%	(0.7)
2001 Q2	1687.2	1755.8	(3.9%)	45.5%	45.7%	(0.2)	1785.7	1844.4	(3.2%)	48.2%	48.0%	0.2
2001 Q3	1613.3	1717.0	(6.0%)	44.8%	45.7%	(1.0)	1761.8	1804.5	(2.4%)	48.9%	48.1%	0.8
2001 Q4	1652.3	1674.2	(1.3%)	45.6%	45.6%	(0.0)	1751.4	1777.7	(1.5%)	48.3%	48.4%	(0.1)
2002 Q1	1618.1	1668.7	(3.0%)	45.9%	45.7%	0.3	1686.1	1760.6	(4.2%)	47.9%	48.2%	(0.3)
2002 Q2	1712.8	1687.9	1.5%	45.6%	45.6%	0.0	1793.8	1785.7	0.5%	47.8%	48.2%	(0.4)
2002 Q3	1714.0	1612.0	6.3%	45.8%	44.7%	1.0	1789.4	1761.8	1.6%	47.8%	48.9%	(1.1)
2002 Q4	1654.2	1652.9	0.1%	45.1%	45.6%	(0.4)	1767.7	1751.4	0.9%	48.2%	48.3%	(0.1)
2003 Q1	1656.6	1618.5	2.4%	45.7%	45.9%	(0.3)	1733.7	1686.1	2.8%	47.8%	47.9%	(0.1)
2003 Q2	1738.0	1713.0	1.5%	45.5%	45.6%	(0.1)	1828.7	1793.8	1.9%	47.9%	47.8%	0.2
2003 Q3	1696.3	1713.9	(1.0%)	45.3%	45.8%	(0.5)	1807.4	1789.4	1.0%	48.2%	47.8%	0.4
2003 Q4	1748.3	1655.1	5.6%	45.5%	45.2%	0.3	1853.9	1767.7	4.9%	48.2%	48.2%	0.0
2004 Q1	1785.4	1702.1	4.9%	45.9%	45.8%	0.1	1851.1	1774.0	4.3%	47.5%	47.7%	(0.2)
2004 Q2	1877.1	1706.0	10.0%	46.6%	45.4%	1.1	1888.9	1803.0	4.8%	46.9%	48.0%	(1.2)
2004 Q3	1883.7	1730.9	8.8%	47.7%	45.4%	2.4	1806.0	1840.5	(1.9%)	45.7%	48.2%	(2.5)
2004 Q4	1893.2	1702.7	11.2%	47.3%	45.3%	2.0	1829.7	1818.0	0.6%	45.7%	48.4%	(2.6)
2005 Q1	1897.8	1783.2	6.4%	47.0%	45.8%	1.2	1853.5	1851.1	0.1%	45.9%	47.6%	(1.6)
2005 Q2	1946.5	1877.5	3.7%	47.9%	46.9%	1.0	1869.1	1888.9	(1.0%)	46.0%	47.2%	(1.2)
2005 Q3	1969.8	1882.9	4.6%	48.8%	48.0%	0.8	1817.3	1806.0	0.6%	45.1%	46.1%	(1.0)
2005 Q4	1963.8	1901.5	3.3%	48.9%	47.7%	1.2	1812.7	1829.7	(0.9%)	45.2%	45.9%	(0.8)
2006 Q1	1975.4	1898.2	4.1%	48.8%	47.4%	1.4	1812.9	1839.2	(1.4%)	44.8%	46.0%	(1.2)

Source: Data Compiled by the Association of American Railroads

Exhibit B

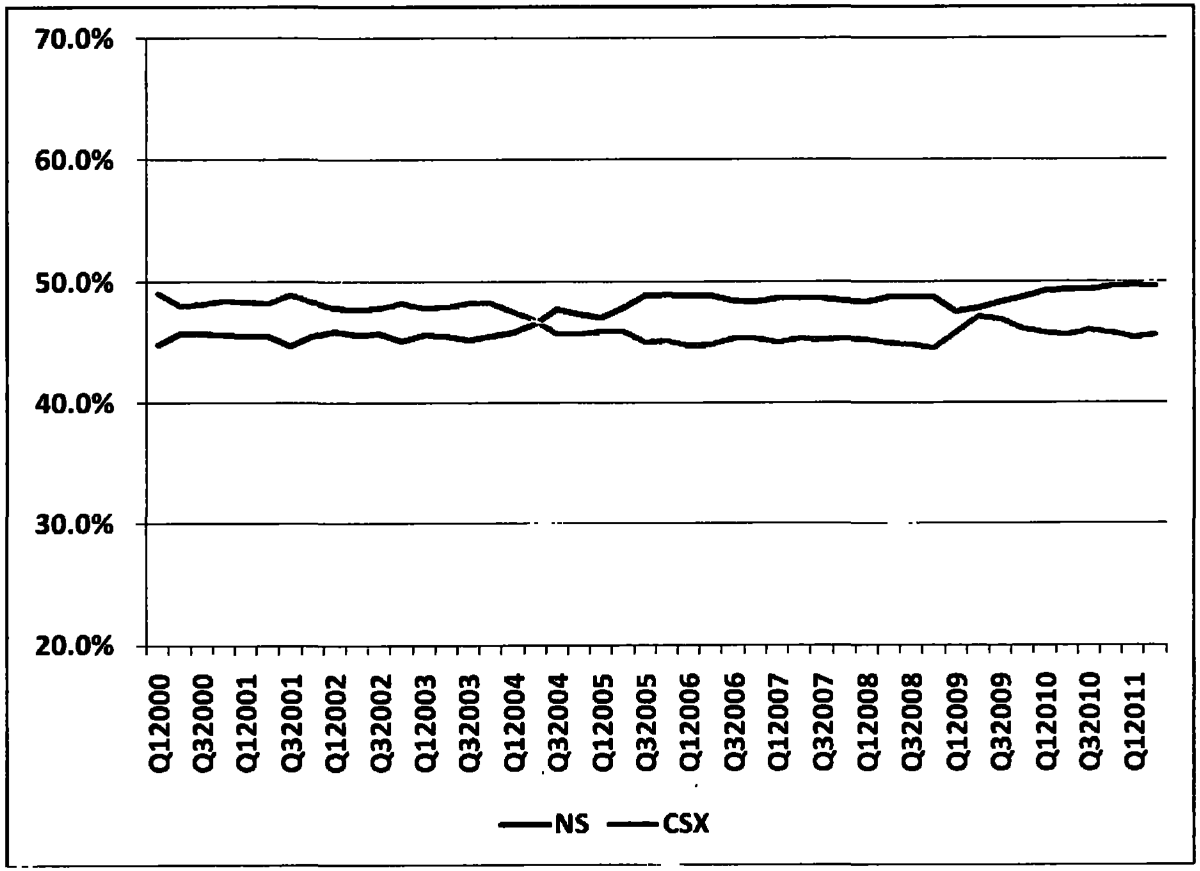
Eastern Carriers Total Traffic Volume and Market Share

	NS						CSX					
	Volume (000)			Market Share			Volume (000)			Market Share		
	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change	Current Q	Previous Year Q	% Change
2006 Q2	2024.3	1946.9	4.0%	48.8%	48.1%	0.7	1860.0	1854.0	0.3%	44.8%	45.8%	(0.9)
2006 Q3	1973.1	1970.0	0.2%	48.5%	49.0%	(0.5)	1844.8	1804.5	2.2%	45.3%	44.9%	0.4
2006 Q4	1916.4	1964.1	(2.4%)	48.4%	49.1%	(0.7)	1798.1	1801.1	(0.2%)	45.4%	45.0%	0.4
2007 Q1	1883.5	1975.4	(4.6%)	48.6%	48.9%	(0.3)	1747.6	1808.5	(3.4%)	45.1%	44.7%	0.3
2007 Q2	1942.3	2024.5	(4.1%)	48.6%	48.8%	(0.2)	1812.7	1860.0	(2.5%)	45.4%	44.8%	0.5
2007 Q3	1895.7	1970.7	(3.8%)	48.7%	48.4%	0.2	1760.2	1844.8	(4.6%)	45.2%	45.3%	(0.1)
2007 Q4	1860.2	1917.1	(3.0%)	48.4%	48.4%	0.1	1742.9	1798.1	(3.1%)	45.4%	45.4%	0.0
2008 Q1	1816.8	1884.0	(3.6%)	48.4%	48.6%	(0.2)	1701.0	1747.6	(2.7%)	45.3%	45.1%	0.2
2008 Q2	1902.3	1942.4	(2.1%)	48.7%	48.6%	0.1	1757.2	1812.7	(3.1%)	45.0%	45.4%	(0.4)
2008 Q3	1868.1	1895.4	(1.4%)	48.8%	48.7%	0.1	1716.4	1760.2	(2.5%)	44.8%	45.2%	(0.4)
2008 Q4	1858.0	1923.2	(3.4%)	48.7%	48.2%	0.5	1698.7	1819.6	(6.6%)	44.5%	45.6%	(1.1)
2009 Q1	1493.8	1858.5	(19.6%)	47.5%	48.4%	(0.9)	1441.9	1735.1	(16.9%)	45.9%	45.2%	0.6
2009 Q2	1400.6	1883.3	(25.6%)	47.9%	49.5%	(1.6)	1379.3	1736.0	(20.5%)	47.1%	45.6%	1.5
2009 Q3	1520.3	1889.6	(19.5%)	48.3%	49.4%	(1.1)	1477.2	1742.8	(15.2%)	46.9%	45.6%	1.3
2009 Q4	1524.3	1666.4	(8.5%)	48.8%	49.4%	(0.6)	1441.9	1529.5	(5.7%)	46.1%	45.3%	0.8
2010 Q1	1626.0	1494.1	8.8%	49.2%	48.3%	0.9	1513.4	1437.4	5.3%	45.8%	46.4%	(0.7)
2010 Q2	1725.6	1400.9	23.2%	49.3%	47.9%	1.5	1595.1	1379.3	15.6%	45.6%	47.1%	(1.5)
2010 Q3	1731.5	1520.3	13.9%	49.3%	48.3%	1.0	1614.2	1477.2	9.3%	46.0%	46.9%	(0.9)
2010 Q4	1678.4	1524.1	10.1%	49.6%	48.8%	0.8	1551.3	1441.9	7.6%	45.8%	46.1%	(0.3)
2011 Q1	1745.2	1626.5	7.3%	49.8%	49.2%	0.6	1595.4	1513.3	5.4%	45.5%	45.8%	(0.3)
2011 Q2	1785.7	1725.5	3.5%	49.7%	49.3%	0.3	1641.1	1594.8	2.9%	45.6%	45.6%	0.0

Source: Data Compiled by the Association of American Railroads

Exhibit B

Eastern Carriers Total Market Share



Source: Data Compiled by the Association of American Railroads

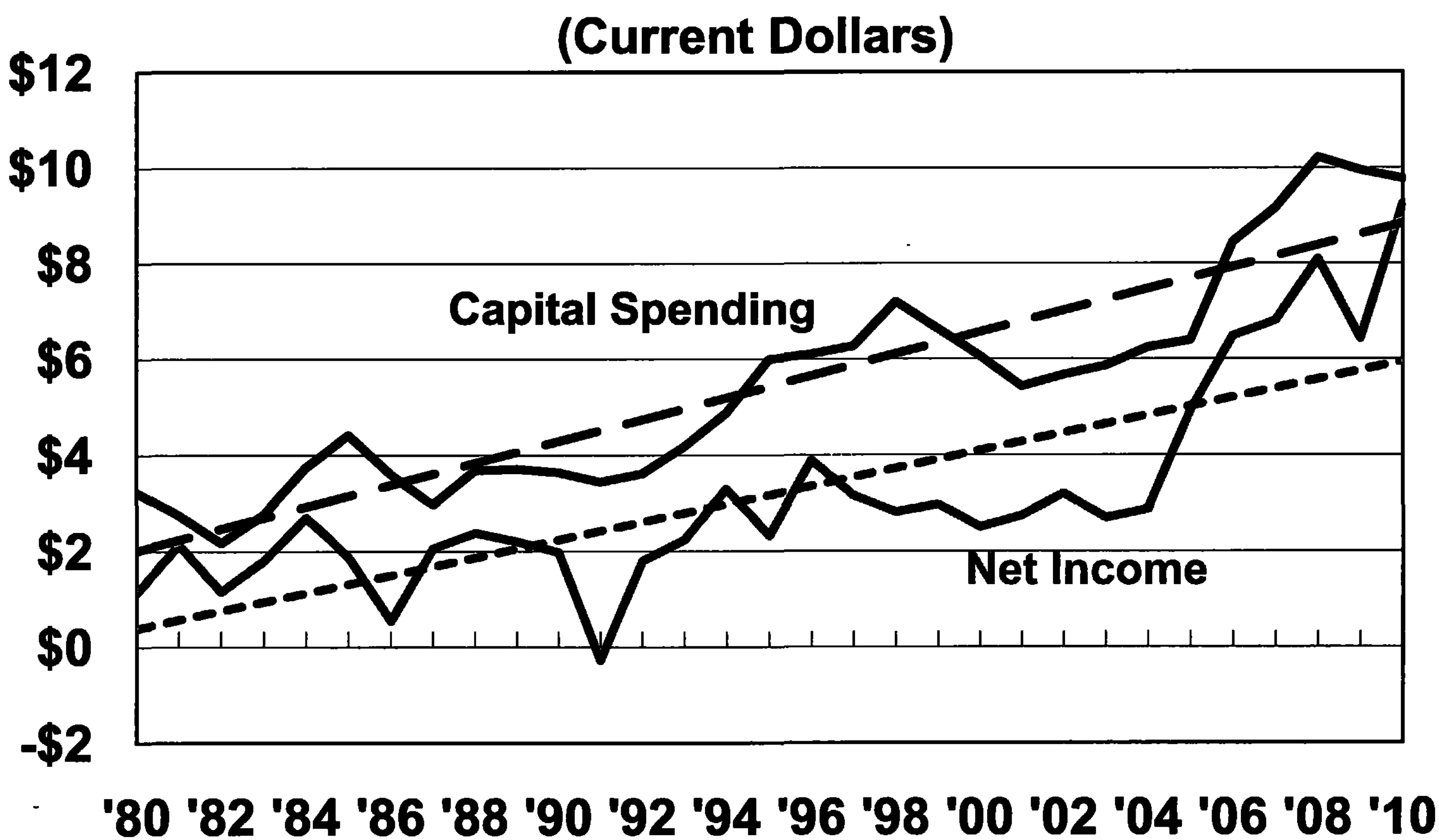
Exhibit B

CARLOAD NETWORK

NORFOLK SOUTHERN RAILWAY COMPANY

Exhibit C

Higher Rail Earnings = Higher Rail Capital Spending



Data are for Class I railroads. 2010 is preliminary Source: AAR

Exhibit D

V. S. SHAW

HIGHLY CONFIDENTIAL VERIFIED STATEMENT
REDACTED PURSUANT TO PROTECTIVE ORDER
ISSUED IN STB EX PARTE NO. 705